USAA Legislative Position Briefing
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PRINCIPLE-BASED RESERVES ("PBR")

Protecting the Affordability and Availability of Life Insurance

PBR HIGHLIGHTS

A PBR bill will amend SC laws consistent with model legislation adopted by the National Association of Insurance Commissioners ("NAIC"). The amendments will pave the way for PBR, an improved method for setting insurance reserves.

- Until PBR takes effect, life insurance reserves will be set as they are today.
- Once PBR takes effect, specific reserve requirements will be in a detailed valuation manual, which will be reviewed and updated as necessary, for instance, to accommodate emerging products.
- PBR uses a combination of a formula, advanced modeling techniques and improved regulatory tools to ensure life reserves more appropriately match actual product and company risks.
- The valuation manual includes an exemption for small companies that write simpler products.
- PBR takes effect after 42 jurisdictions representing 75% of national premiums pass PBR-enabling legislation. It only applies to policies issued on or after the PBR effective date, and companies have up to three years to implement.

FREQUENTLY ASKED QUESTIONS

WHAT ARE LIFE INSURANCE RESERVES AND HOW ARE THEY CURRENTLY CALCULATED?

Reserves are funds life insurers must set aside to pay future benefits. The current method for calculating life reserves uses a formulaic, one-size-fits-all approach that dates back to the 1850's. It has not kept pace with modern day life insurance products and reserve levels in many cases do not reflect actual product risks.

WHAT IS PBR?

It is a new and improved method for calculating life insurance reserves. It uses a combination of a safety-net formula and advanced modeling techniques to better reflect and measure the risks of modern life insurance products.
The main purpose of PBR is to more closely match reserves to the actual risks being assumed by life insurance carriers.

IN ADDITION TO REFINING RESERVE RULES, ARE THERE OTHER ADVANTAGES TO PBR?

Since detailed PBR rules will be in a separate valuation manual, they will be more adaptable to, for instance, changing product designs. Contrast PBR flexibility with current rules that are hard coded in laws and regulations.

Also, states will get detailed information on the methods, assumptions and modeling used by companies to set reserves. States will have a better picture of companies and their financial wellbeing.

John P. Friedman, VP Government & Industry Relations, USAA | john.friedman@usaa.com |(973) 377-6662

WILL PBR BE GRADUALLY IMPLEMENTED ?

PBR will only take effect after 42 jurisdictions accounting for 75 percent of national insurance premiums adopt the revised NAIC model valuation law. To date, approximately 28 states accounting for more than 43 percent of life insurance premiums have done so.

Also, the new reserve requirements under PBR will only apply to life insurance policies sold after the PBR effective date. And carriers will have three (3) years to implement PBR even after it takes effect.

TO WHICH PRODUCTS WILL PBR APPLY?

According to the valuation manual, all life insurance policies except credit life and pre-need policies will be subject to at least some of the new requirements. The valuation manual provides criteria designed to exclude simpler and less risky products from the modeling requirements of PBR. This means reserves for products meeting exclusion criteria will be calculated using a formula similar to what is used today.

IS THERE A SMALL COMPANY EXEMPTION?

The valuation manual includes an exemption for small companies that write simpler products since the additional modeling PBR may require is not needed for the products small companies generally write. Small companies meeting exemption requirements (e.g., less than $300 million life premium and $600 million for a group of life insurers) will continue to use the current reserve rules. Some states have referenced the exemption in their revised law.

WILL RESERVES INCREASE OR DECREASE UNDER PBR?

Any increase or decrease in reserves is less important than making sure reserves are calibrated to more accurately reflect product and company risks. That said, according to a 2012 NAIC study, term life insurance reserves are generally expected to decrease, universal life insurance with secondary guarantee products may increase or decrease depending on product and company characteristics, and reserves for other products are generally expected to remain the same.

HOW WILL THE VALUATION MANUAL BE UPDATED?

The valuation law will have general requirements and guidelines with detailed rules in the valuation manual. At least three quarters of NAIC voting members representing at least 75% of national premiums will have to approve any changes to the valuation manual. This is the same structure and process used today for insurance accounting requirements.

HOW DOES PBR BENEFIT LIFE INSURANCE POLICYHOLDERS?

PBR will help ensure the continued availability and affordability of life insurance products because life insurance reserves will more closely reflect the risks of life insurance carriers and their products and will not reflect a one-size fits-all formulaic approach. In addition, PBR will provide life insurance carriers with more flexibility to develop and reserve for new products.

PBR is broadly supported by the NAIC, the American Academy of Actuaries, the American Council of Life Insurers and insurance professionals nationwide.

John P. Friedman, VP Government & Industry Relations, USAA | john.friedman@usaa.com |(973) 377-6662