ACLI
Financial Security...for Life.

Public Policy Issue Brief

PRINCIPLE-BASED RESERVES (PBR)

BACKGROUND

Life insurers set aside capital—called reserves—to ensure they will be able to pay all future expected claims. State insurance regulators closely monitor reserves and take action if a company's reserve levels jeopardize policyholders' interests.

The current system to calculate reserves dates back to Civil War times and utilizes a formulaic, one-size-fits-all approach to determine those reserves. Many regulators and life insurance companies believe that reserve requirements need to evolve in order to keep pace with new product designs. For nearly a decade, state regulators, with the support of life insurers and actuaries, have developed a new method for calculating life insurance policy reserves. This proposal replaces that system with a principle-based reserving (PBR) approach that "right sizes" the reserve to ensure that it matches the actual risk being assumed. The new PBR approach will enhance the current system for calculating policy reserves, resulting in reserve levels that more accurately reflect risks assumed by life insurers for the policies they underwrite. This new system will provide regulators with tools to properly monitor a life insurer's reserve levels through annual reporting and review.

To implement PBR, state legislatures must adopt both the Standard Valuation Model Law that was approved by the National Association of Insurance Commissioners (NAIC) in 2009, and the 2012 revisions to the NAIC Standard Nonforfeiture Law. PBR will only be operational once it has been adopted in at least 42 U.S. jurisdictions, accounting for 75 percent of U.S. life insurance premiums combined.

PBR legislation benefits consumers in three distinct ways:

- PBR helps to ensure that consumers are paying the appropriate price for the insurance coverage being provided.
- PBR helps insurance companies develop and reserve for new products and product features that the current system inhibits.
- PBR strengthens the solvency oversight authority of regulators to help ensure that companies will be able to fulfill their promises.

STATUS

To date, 41 states have enacted legislation to implement principle-based reserving: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia, and Wisconsin.

ACLI POSITION

ACLI supports the implementation of PBR and encourages state legislatures to adopt the revisions to the Standard Valuation Model Law and the revisions to the NAIC Standard Nonforfeiture Law. PBR has been designed to enhance regulatory oversight, not to weaken it. It is in the interest of the entire industry and its policyholders that companies are well capitalized.

AT A GLANCE

- Life insurers are heavily regulated at the state level to protect consumers. The state-based regulatory system enforces strict solvency oversight to ensure the industry fulfills its promises to policyholders.
- PBR has been under development for close to a decade. During that time, it has been subject to actuarial modeling, testing, and refinement.
- PBR will help reserve requirements keep pace with new product designs from life insurers to meet consumer needs.
- Under PBR, regulators will have access to more tools to properly monitor reserve levels and ensure that companies are able to meet their commitments to policyholders.
- PBR allows reserves to be tailor-made for every company to match its unique risks, instead of taking a regulatory one-size-fits-all approach.
- PBR is supported by the NAIC, the American Academy of Actuaries, and ACLI.
- PBR is not a new concept—it is currently used by property casualty and health insurance companies in the states and in international insurance markets.
- Life insurers' reserves allow companies to provide affordable products with long-term guarantees that protect families' financial security and allow for a dignified, independent and secure retirement.
- Life insurers provide long-term financial protection to 75 million American families and thus companies must manage their assets with these long-term risks in mind.
- In 2013, U.S. life insurers provided payments in excess of $564 billion, helping families guarantee long-term financial security now and in retirement.

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LAST REVIEW DATE: MARCH 2016
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