Principle-based reserving update

New York adopts PBR, implementation in 2018

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The New York Department of Financial Services (NYDFS) announced on July 6, 2016 adoption of principle-based reserving (PBR) for regulated life insurers beginning January 1, 2018. The move provides further assurance of regulatory uniformity for life insurer reserving in New York. Forty-five other states representing nearly 80 percent of the market that have enacted laws implementing PBR and will begin reserving in accordance with PBR effective January 1, 2017, as noted in KPMG LLP's (KPMG) recent Points of View publication. New York's adoption brings the total number of states to 46 with nearly 89 percent of premium.

This is a significant departure from previous department policy as New York was one of few states opposed to refining the reserving methodology. The reasons for opposing it focused on perceptions that PBR processes had been responsible for banking sector failures, lower reserves will increase insurer insolvency risks, unclear benefits to the consumer, and state regulator's lack of expertise.

The decision may also have further implications. New York has a tradition of conservative regulation. At times, it takes a different approach than the majority of state insurance departments. New York State also is a prominent insurance regulator with a precedent of applying many of its laws extraterritorially to insurers licensed to do business in New York rather than only to domestic insurers. The decision marks a significant departure from these traditions by showing that New York is conforming to standards set in other states. Any shift by NYDFS to increase cooperation and collaboration with fellow state insurance regulators and the National Association of Insurance Commissioners (NAIC) would help create a more nationally uniform approach just as federal intervention in insurance regulation increases.

Background summary

On June 10, 2016, the NAIC announced it adopted the recommendation for PBR implementation beginning January, 1, 2017, after conducting an analysis of the amended Standard Valuation Law passed in 45 states representing nearly 80 percent of the U.S. life insurance market.

As summarized by the PBR Implementation Task Force[1]:

— Insurers set aside funds, or reserves, to pay insurance claims when due. Currently, formulas and assumptions are used to determine these reserves, as prescribed by state laws and regulations.

— Companies will hold the higher of a) the reserve using prescribed factors and b) the reserve that considers a wide range of future economic conditions and is computed using justified company experience factors, such as mortality, policyholder behavior, and expenses.

— The Valuation Manual is established by the Standard Valuation Law and would be used to detail the reserve calculation requirements.

— The new Standard Valuation Law and Valuation Manual are built to encompass requirements for all life and health insurers and the business they write. Initially, reserving methods only change for life insurance. However, over time, PBR is expected to be developed for additional product lines.

For additional information and insight, see Insurance principle-based reserving: Emerging industry challenges and opportunities.

[1] http://www.naic.org/cipr_topics/principle_based_reserving_pbr.htm

The decision by the NYDFS converges with this national trend. Given the NYDFS tradition of taking independent separate action, the convergence with emerging national consensus is remarkable but does not alter the overall regulatory policy trajectory in the United States with respect to reserving policies for life insurers. It does, however, suggest the possibility of convergence in other regulatory policy areas currently under discussion, particularly the reserving policies regarding captive insurers.

Life insurers have raised questions with the Internal Revenue Service (IRS) regarding how PBR will affect the computation of life insurance reserves for federal income tax purposes. The IRS has a PBR item on its current Priority Guidance Plan and is working to provide timely guidance regarding how PBR will affect life insurance reserve computations under Internal Revenue Code Section 807. Multiple issues, including how to handle the transition to PBR and whether the stochastic element of the PBR computation will be included in tax reserves, are open and will hopefully be addressed in a series of IRS guidance. The timing of the forthcoming guidance is uncertain, but some guidance is expected prior to December 31, 2016.

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