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Executive Compensation ■ Succession ■ Wealth Transfer Planning

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M Intelligence

Enhancing understanding of sophisticated planning strategies and their applications.

The Potential Impact of Principles Based Reserving on Product Cost

Principles Based Reserving (PBR) is a new regulatory regime that must be implemented for all new life insurance policies by January 1, 2020. The current reserve methodology, based on prescribed, formulaic methods and assumptions, has been fundamentally unchanged for 150 years. Meanwhile, product designs have increased in complexity and flexibility. Under PBR, required reserves are determined reflecting the unique risks underlying each insurer's life insurance business. A resulting benefit of this regulation is avoiding over- or under-charging the customer for reserve costs.

While the competitive landscape continues to evolve and implementation is still in the early stages among carriers, some themes and potential implications have begun to emerge:

- Most industry analysis to date on PBR impact has centered on Term and NLG products, but substantial uncertainty remains.
  - Term reserves are expected to generally decrease, but depending on how efficiently insurers have financed reserves, policy premiums may increase or decrease.
  - NLG reserve impact, and resulting product cost, will vary by the design, strength of the guarantee, reinsurance cost, and reserve financing.
- Low cost, protection-focused UL/IUL/VUL products often exhibit lower cash value performance, short-to-medium duration NLG features, and relatively low costs among permanent UL product types. Our preliminary assessment is that PBR methodology eliminates a pricing arbitrage allowed under the current reserving rules to support these products. With this arbitrage removed, the industry may experience an increase in the cost of protection-focused UL/IUL/VUL products.
- For accumulation-focused UL/IUL/VUL products, which exhibit strong cash value performance and higher relative product costs, the impact is expected to be minimal.

M Financial is monitoring the implementation of PBR and evaluating the impact of this regulation on proprietary products as they transition to 2017 CSO and PBR simultaneously. As more certainty around impact emerges, we will keep Member Firms informed.

Variable life insurance products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and it entails risk, including the possible loss of principal.

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