

The Valuation Manual

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Academy Valuation Law & Manual Team (VLMT) June 2007 Report

VLMT June 2007 Report Includes:

- Report
- Slide Presentation
- Draft Valuation Manual



Subgroups

- Subgroup 1 (Dave Neve) - Principles-Based reporting and review requirements.
- Subgroup 2 (Mike Boerner) - Subgroup drafting the Valuation Manual.
- Subgroup 3 (Russ Menze) - Developing experience reporting requirements, instructions, forms for reporting, and analysis considerations.
- Subgroup 4 (Pam Hutchins) - Working with the Academy Life Reserves Work Group to address principles-based requirements for products with less risk.



Subgroup 1 Status (Chair – Dave Neve)

- Developed reporting requirements for life principles-based reserves.
- Also developed reporting requirements that may be applicable to any product under principles-based reserves.
- Subgroup 1 will continue work to develop reporting requirements specific to other product lines as directed by LHATF.



Subgroup 1 Status

Annual Principles-Based Review

- Subgroup 1 teamed with members of Shirley Shao's Academy Principles-based Review and Governance Work Group to review issues regarding these requirements.
- Key issues include whether a company or the state hires the independent reviewer, and the degree of reliance a state can place on the work if the company hires the reviewer.



Subgroup 1 Status

Annual Principles-Based Review (cont.)

- Subgroup 1 concluded a state's annual financial analysis and periodic examination work will benefit from the independent review even if the company hires the reviewer. This is similar to the benefit provided in regulator use of the annual independent audit. This benefit is enhanced with reporting provided by the independent review.
- Subgroup 1 recommends exposure of these requirements as provided to LHATF at the March meeting. A copy of these requirements is enclosed with the Draft Valuation Manual provided at this meeting.
- LHATF SVL2 Subgroup will work with this and other issues regarding the Annual Principles-Based Review requirements.



Subgroup 2 Status (Chair – Mike Boerner)

- Developed a draft of the Valuation Manual.
- This draft is not complete where formatting and additional sections are yet to be added.
- Purpose of this draft is to provide an understanding of the direction and status of the Valuation Manual.
- September is the goal for a more complete version of the Valuation Manual.

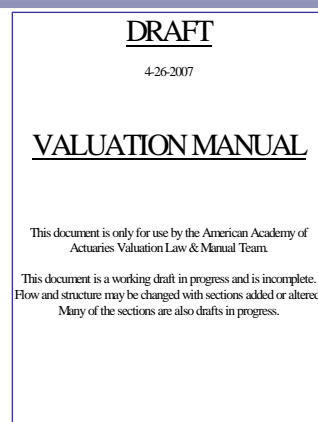


Accounting Practices & Procedures Manual (APPM) Coordination

- Subgroup 2 is drafting the Valuation Manual keeping in mind a process and goal to coordinate with the APPM.
- Subgroup 2 members, Dave Christensen and Milum Livesay, have developed a direction for how the APPM can reference the Valuation Manual. These members will discuss this direction with the NAIC Statutory Accounting Principles Working Group at this NAIC meeting.
- The next few slides illustrate this direction.



APPM Coordination With Valuation Manual (VM)



Objectives:

- ❑ Keep it simple!
- ❑ Maintain the current connection between accounting and reserve standards
- ❑ Minimize ongoing Statutory Accounting Principles WG maintenance
- ❑ Provide a historical record



Current and Future Structure

All pronouncements currently contained with the AP&P

Multiple SSAPs

Appendix A – Excerpts of Model Laws

Appendix C – Actuarial Guidelines

Future

Maintained outside the AP&P

Single SSAP

PBR Valuation Manual



Coordination Will Require Detailed Review Efforts Leading to New SSAP

SSAPs which include reserve standards will need to be reviewed and superseded by a new SSAP with a unique effect date

- ❑ Life contracts (including annuities)
- ❑ A&H contracts
- ❑ Deposit-Type contracts
- ❑ Separate accounts
- ❑ Life reinsurance

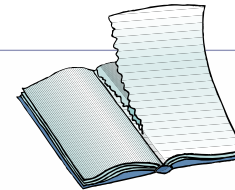
SSAPs

51, 52, 54,
56, 59, 61,
80, 88 ¶9f



NEW SSAP Could Refer to VM as SSAP 7 Does for IMR and AVR

SUMMARY CONCLUSION



2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

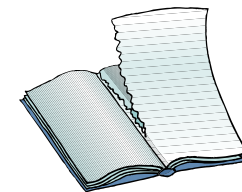
3. The IMR and AVR shall be calculated and reported in accordance with the NAIC *Annual Statement Instructions for Life and Accident and Health Insurance Companies*.



New SSAP Could Coordinate Timing as SSAP 80 Does For Certain SSAPs

STATUS

Type of Issue:	Life and Accident and Health
Issued:	Finalized December 4, 2000
Effective Date:	January 1, 2001
Affects:	Supersedes paragraph 43 of SSAP No. 51 Supersedes paragraph 19 of SSAP No. 52 Supersedes paragraphs 26 and 33 of SSAP No. 56
Affected by:	No other pronouncements
Interpreted by:	No other pronouncements



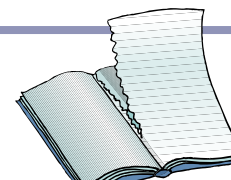
New SSAP will contain its own effective date allowing for prospective accounting

Effective Date

9. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state.



SSAP 51 Provides Example of Superseded Requirements



Relevant Literature

43. This statement incorporates the requirements of Appendices A-225, A-235, A-585, A-620, A-812, A-820, A-821, A-822, A-825, and the Actuarial Standards Board *Actuarial Standards of Practice*.

All Appendix A and C documents which are superseded by the new SSAP will be shaded and remain in the APPM for the foreseeable future



Enables the Valuation Manual to focus on Prospective Contracts



Subgroup 3 Status (Chair – Russ Menze)

- Subgroup 3 has refined the experience reporting requirements. This section includes information to assist the NAIC in establishing the experience reporting process and subsequent analysis.
- The subgroup has also developed an appendix with a life insurance reporting template and instructions. Simplified instructions are provided for companies with less premium volume for the year.
- Reporting instructions and templates that may be used for other product lines are still to be developed.



Subgroup 3 Status

Current Direction

- Possible scope of companies and business for experience reporting is the scope of companies and business pursuant to the exposed Standard Valuation Law. This could include all in force life, annuity, and health business.
- Currently the experience reporting draft provides experience reporting instructions only for life insurance. Requirements that may be used for other products are to be developed.
- LHATF input needed regarding the scope of companies and business subjected to experience reporting requirements for the first year of reporting.
- Draft anticipates that experience reporting requirements would be updated each year and made specific for that calendar year's reporting.



Subgroup 4 Status (Chair – Pam Hutchins)

- Subgroup 4 has been working with the Academy's Life Reserves Work Group to address principles-based applications for simpler forms of business.
- This liaison has produced the concept of a material tail risk test for business to determine if a simpler deterministic approach can be used.
- Modeling will be performed to better assess and clarify instructions for this material tail risk test. This test is currently reflected in the Academy's LRWG document provided at this meeting.



Subgroup 4 Survey

- Subgroup 4 developed a survey distributed by Randall Stevensen to LHATF and interested state regulators.
- Survey elicited feedback on types of business which should be subject to principles-based reserves on the Valuation Manual operative date versus later.
- A summary of the survey responses is attached to the VLMT report to LHATF.



Subgroup 4: Possible Phase In

- Three phases
- Control implementation of each phase through Valuation Manual
- As experience is gained with each phase, refinements may be made to requirements and methodologies through the Valuation Manual.



Phase 1: Apply PB Reserves to Products With More Risky Characteristics

- Examples:
 - Products that use Separate Accounts.
 - Products that contain long-term secondary guarantees (e.g., 20 years or more).
 - Term products with initial level guaranteed period of 20 years or more.
 - Products that contain interest crediting based on an equity index.



Phase 2: Make Refinements Based on Phase 1 Experience

- For example, apply principles-based reserves to fund based products and all other individual term insurance.
- Implement Material Tail Risk test (MTR)



Phase 3: Make Refinements Based on Phase 2 Experience

- Subject other products to principles-based reserves except those with continued exemptions. Exemptions might include (see Subgroup 4 survey results):
 - Credit Life & Disability
 - Final Expense
 - Traditional Whole Life



Draft Valuation Manual - Objectives

- Implement principles-based reserves.
- Include all other non-principles-based reserves.
- Provide reserve requirements in one place.
- Construct Valuation Manual so that the APPM can use the same requirements.
- Coordinate with APPM to achieve one exposure and one adoption process.



Draft Valuation Manual - Objectives

- Enhance uniformity and efficiency by using requirements in Valuation Manual versus current process of adopting NAIC model reserve requirements and separate adoption of similar requirements in the APPM.
- Achieve maintenance efficiencies in ability to update Valuation Manual requirements on an annual basis.
- Work with NAIC - Statutory Accounting Principles Working Group (SAPWG) to have Valuation Manual published within the APPM.



Draft Valuation Manual - Qualifications

- Provided to give an understanding of the direction and construction of the manual.
- Formatting and flow is incomplete.
- Several sections are to be added along with additional work on current sections.
- A more complete version of the Valuation Manual will be provided in September 2007.



Draft Valuation Manual Sections

- Introduction.
- Section 1: Principles-Based Overview
- Section 2: Authority & Applicability
- Section 3: Reserve Requirements
- Section 4: Reporting Requirements
- Section 5: Annual Principles-Based Review Requirements.
- Section 6: Experience Reporting Requirements.
- Section 7: Appendices



Section 3: Reserve Requirements

- Life: LRWG principles-based requirements plus non-principles based requirement.
- Annuity: VACARVM requirements provided. ARWG requirements to be provided when complete.
- Deposit-Type Contracts
- Health: Current NAIC requirements.
- Credit Life & Disability: Current NAIC requirements.



Section 4: Reporting Requirements

- Contains current actuarial opinion and memorandum requirements.
- Provides for principles-based reporting requirements.
- Current draft provides life principles-based reporting requirements.
- Draft also provides principles-based reporting requirements that may be applicable to any product.



Section 5: Annual Principles-Based Review Requirements

- Contains requirements similar to current exposure.
- The exposed document has been reformatted from the current exposure model rule format to a requirements type format.



Section 6: Experience Reporting Requirements

- Experience reporting may be applicable to products subject to principles-based reserves.
- Life reporting template and instructions have been drafted.
- Simplified experience reporting provided for companies with low premium volume
- Other product instructions are to be developed.



Section 7: Appendices

- Appendix A contains guidance. Currently the Health Reserves Guidance Manual appears here.
- Appendix B contains experience reporting templates and instructions.
- A separate Appendix SA will provide information for NAIC consideration regarding Statistical Agents.



Upcoming Efforts Prior To The September 2007 Meeting

- Detailed review of APPM
- Provide requirements for non-principles-based application.
- Formatting & structure changes for consistency.
- Provide ARWG draft requirements.
- Provide a substantially complete draft of the Valuation Manual.



Areas For LHATF Input

- Business which should continue current requirements on operative date of Valuation Manual.
- Input on direction of Material Tail Risk test which is intended to determine whether business can use a simpler deterministic approach.
- Initial thoughts for low-risk types of annuity products which could be exempted from principles-based reserves or which could make use of a simpler deterministic approach.
- Scope of experience reporting requirements on operative date of Valuation Manual.
- Thoughts on the NAIC process for the collection and analysis of experience reported.



Possible Timing

- September 2007: Academy VLMT substantive completion of Valuation Manual.
- March/June 2008: NAIC adoption of Valuation Manual.
- 2008 – 2009: State legislative adoption of changes to the Standard Valuation Law.
- January 1st 2010: Effective date of Valuation Manual for adopting states.

