

# Amendment Proposal Form\*

(NAIC Research Division)

1. Identify yourself, your affiliation and a very brief description (title) of the issue.

Robert DiRico, American Academy of Actuaries' Consistency Work Group  
Updated VM-00 Overview of Reserve Concepts

2. Identify the document, including the date if the document is "released for comment," and the location in the document where the amendment is proposed:

VM-00 Exposure Draft, dated 2/18/09 and located on the NAIC website

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on "track changes" in Word®) version of the verbiage. (You may do this through an attachment.)

## OVERVIEW OF RESERVE CONCEPTS

### Replace the prior paragraph with the following:

[Reserve requirements prescribed in the Valuation Manual support a statutory objective of conservative valuation to provide protection to policyholders and promote solvency of companies against adverse fluctuations in financial condition or operating results pursuant to requirements of the SVL. Requirements in the Valuation Manual are consistent with the appropriate measurement of this objective and related objectives as set forth in the Preamble to the *Accounting Practices and Procedures Manual* in the Statutory Accounting Principles Statement of Concepts.]

**Deleted:** Reserve requirements prescribed in the Valuation Manual are intended to support a statutory objective of conservative valuation to provide protection to policyholders and promote solvency of companies against adverse fluctuations in financial condition or operating results pursuant to requirements of the SVL. ¶

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### Replace the prior paragraph with the following:

[A principle-based valuation is a prospective risk-based reserve valuation identified as a principle-based valuation in this Manual, that captures material risks underlying the policies being valued and the assets supporting those policies including the benefits and guarantees, the impact of material tail risk, the revenue available to fund the risks, and the effect of any risk mitigation techniques. A key characteristic of a principle-based valuation is utilizing the company's experience, to the extent credible, to establish valuation assumptions that are specific to the company. This is in contrast to reserve valuation approaches that rely primarily on prescribed valuation assumptions and methods that are the same for all companies. The purpose of this section of the Manual is to provide an overview of the concepts considered in the development of the principle-based valuation requirements contained within this Valuation Manual.]

**Deleted:** A principle-based valuation is a reserve valuation that uses one or more methods or one or more assumptions determined by the insurer pursuant to requirements of the SVL and the Valuation Manual. This is in contrast to valuation approaches that use only prescribed assumptions and methods. Although a reserve valuation may involve a method or assumption determined by the insurer, such valuation is a principle-based valuation only as specified in the Valuation Manual for a product or category of products.

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Risks that should be reflected in the principle-based valuation are those that arise from future events or activities that are both:

1. Directly related to those policies or contracts, or their supporting assets; and
2. Determined capable of materially affecting the reserve.

Examples of such risks include the risk associated with policyholder behavior (such as lapse and utilization risk), mortality risk, interest rate risk, asset default risk, separate account fund performance, and the risk related to the performance of indices for contractual guarantees.

For the purpose of these requirements, 'risks underlying the policies being valued and the assets supporting those policies' do not include risks that are of a general business nature that are not specific to the insurance contract, or risks that are not readily quantifiable. Examples of these types of risks include reputation risk and fraud/theft risk

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The requirements for a principle-based valuation were developed based upon the following concepts:

1. Capture the benefits and guarantees associated with the contracts and the identifiable, quantifiable and material risk associated with each product, including the funding of such risks. For policies or contracts with significant tail risk, incorporate conditions appropriately adverse to reflect the tail risk.
2. Utilize risk analysis and risk management techniques to quantify the risks and is guided by the evolving practice and expanding knowledge in the measurement and management of risk. This may include, to the extent required by an appropriate assessment of the underlying risks, stochastic models or other means of analysis that properly reflect the risks of the underlying contracts.
3. Incorporate assumptions, risk analysis methods and models and management techniques that are consistent with, those utilized within the company's overall risk assessment process. The inclusion of the risk analysis methods and models should consider the original purpose of that analysis. Risk and risk factors explicitly or implicitly included in the company's risk assessment and evaluation processes will be included in the risk analysis and cash flow models used in the principle-based valuation. Examples of company risk assessment processes may include economic valuations, internal capital allocation models, experience analysis, asset adequacy testing, GAAP valuation and pricing.
4. Utilize the company's anticipated experience, based on the availability of relevant company data and its degree of credibility, to establish assumptions for risks specific to the company and over which the company has some degree of control or influence.
5. Incorporate assumptions that, when viewed in the aggregate, reflect an appropriate level of conservatism and, together with the methods utilized, recognize the solvency objective of statutory reporting.
6. Reflect risks that may be different from those used to calculate statutory risk-based capital.

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Deleted: and risk factors in the calculation of the principle-based valuation minimum statutory reserves and statutory RBC

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4. State the reason for the proposed amendment? (You may do this through an attachment.)

We (the Academy's Consistency Work Group) believe that the changes to the first 2 paragraphs provide greater clarity and definition about what is discussed later in this section and about what comprises a principle-based valuation. Since the SVL definition relies on the valuation manual to provide detail and clarity on what comprises a principle-based valuation, we believe these changes are necessary.

The addition of the risks reflected in reserves section (paragraphs 3-5) was made in order to create consistency on how these requirements would be applied. Specifically, we believe that in the absence of some guidance, such as we present here, a situation could easily develop whereby one state seeks to include some risks in reserves that other states may believe are to be covered by the RBC calculation.

Finally, we believe that the 6 concepts of a PBV need to be stated here for several reasons: while they are stated in some degree in Section 12 of the SVL, they are not stated there in their entirety; since the SVL looks to the Valuation Manual (through the definition of a PBV in the SVL) to provide clarity on what constitutes a principle-based valuation it seems to follow that the concepts of a PBV should be in the valuation manual; there is no other place in the valuation manual that these concepts appear together; for future reference, we believe that the 'original intent' of what constitutes a PBV should be retained so that there are potentially fewer misunderstandings in the future on the issue.

\* This form is not intended for minor corrections, such as formatting, grammar, cross-references or spelling. Those types of changes do not require action by the entire group and may be submitted via letter or email to the NAIC staff support person for the NAIC group where the document originated.

NAIC Staff Comments:

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<b>Dates:</b> Received	Reviewed by Staff	Distributed	Considered
<b>Notes:</b>			

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