



AMERICAN ACADEMY *of* ACTUARIES

Valuation Manual Draft Introduction and Preamble From the American Academy of Actuaries' Valuation and Law Manual Team

**Presented to the National Association of Insurance Commissioners'
Life and Health Actuarial Task Force**

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INTRODUCTION

BACKGROUND

As insurance products have increased in their complexity, and as companies have developed new and innovative product designs that create additional risk for the company, the need to develop a new valuation methodology to address these changes has led to the development of a Principles-based approach (PBA) for valuation requirements. The need has also arisen to develop a valuation standard that would enhance uniformity among the PBA valuation requirements in the various states, and to define a process to facilitate future changes in valuation requirements on a more timely and efficient basis.

The goals of the National Association of Insurance Commissioners (NAIC) in developing this Valuation Manual were:

1. To consolidate in one document all of the minimum reserve requirements for life, annuity and health products as required by the NAIC Standard Valuation Law (SVL), including those products subject to PBA valuation requirements and those not subject to PBA valuation requirements.
2. To promote uniformity among states' valuation requirements, specifically with regard to those products that are subject to PBA valuation requirements.
3. To provide for an efficient, consistent, and timely process to update valuation requirements as the need arises.
4. To mandate the specific reporting requirements of experience data.
5. To specify the content and format of an annual independent actuarial review.
6. To enhance industry compliance to the 2006 revisions to the SVL, (i.e. sections 2b. and 2c.), as adopted in various states.

[Drafting note – The drafting Team is still discussing the concept of an additional section to detail the guidelines and expectations for required sensitivity testing, the reporting of the company's key risk drivers and emerging actual to expected results.]

DESCRIPTION OF MANUAL

This Valuation Manual (“Manual”) contains valuation requirements adopted by the NAIC and provides guidance to actuaries of companies which are required to comply with PBA valuations.

It is divided into five sections, not including the Introduction section. The first section is the Principles-based Preamble, which describes the concepts underlying a PBA valuation, the elements common to all PBA valuations, and the process required to implement a PBA valuation.

The second section is the Valuation Manual Requirements, which defines the companies and products encompassed by the Manual. It also describes the reserve requirements that apply to the inforce business as of the effective date of the Manual, and those requirements that apply to business issued on or after the effective date of the Manual.

The third section enumerates requirements for an annual independent PBA review.

The fourth section delineates the reporting requirements for any company experience that was employed in the PBA valuation.

The fifth section contains guidance, interpretations and actuarial guidelines supporting the sections mentioned above.

[(Drafting note – The drafting Team is still discussing the concept of an additional section to detail the guidelines and expectations for required sensitivity testing, the reporting of the company's key risk drivers and emerging actual to expected results.)]

PROCESS FOR UPDATING MANUAL

[Drafting Note: Considerations on the NAIC process to update the Manual are under development. Such considerations will reflect that the Manual may be modified by the NAIC from time to time in accordance with due process procedures adopted by the NAIC: as new products are developed, as industry feedback is received, or as the methodology may be refined by technological advances.

Such modifications may include, for example, adding new PBA requirements as they are developed, changing the reporting requirements or the PBA independent review process, or providing guidance and interpretation necessary for implementing requirements.]

PRINCIPLES-BASED PREAMBLE

CONCEPT

A Principles-based approach (PBA) for valuation is one that utilizes company specific experience-based assumptions, and permits latitude in an actuary's choice of valuation assumptions and methods in order to more appropriately reflect risks specific to the company. This is in contrast to previous valuation approaches that have used prescribed assumptions and methods that are the same for all companies. A PBA valuation typically involves a projection of a contract's cash flows as a basis for quantifying the financial risk of future losses. This projection could be a single scenario, or it could involve multiple scenarios with some of the valuation assumptions being modeled stochastically.

COMMON ELEMENTS

A Principles-based approach (PBA) refers to an approach to calculate insurance company statutory reserves and capital requirements that has the following elements:

1. Captures all of the identifiable, quantifiable and material risks, benefits, and guarantees associated with the contracts, including the 'tail risk' and the funding of the risks.
2. Utilizes 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. Incorporates assumptions and methods that are consistent with, but not necessarily identical to, those utilized within the company's overall risk assessment process. Company risk assessment processes include but are not limited to experience analysis, asset adequacy testing, GAAP valuation and pricing.
4. Permits the use of company experience, based on the availability of relevant company experience and its degree of credibility, to establish assumptions for risks over which the company has some degree of control or influence.
5. Provides for the use of assumptions, set on a prudent best estimate basis, that contain an appropriate level of conservatism when viewed in the aggregate and that, together with the methods utilized, recognizes the solvency objective of statutory reporting.

IMPLEMENTATION

For business issued on and after the effective date of the Manual, the Manual will contain the necessary information to calculate the minimum reserves for those products subject to PBA requirements adopted by the NAIC as of that date. These requirements are found in Appendix B. Section III of the Manual addresses the circumstances under which policies issued after the effective date of the Manual that would otherwise be subject to PBA requirements will be allowed to continue using the current valuation requirements as an acceptable alternative.

For any products for which new requirements have not been adopted, the Manual will specify current NAIC valuation requirements.

Since Principles-based reserves will be calculated using experience-based assumptions and methods that involve actuarial judgment, it is important that companies review valuation assumptions and methods on an annual basis, and make updates as appropriate. The Manual will address this in three ways:

1. The Manual will provide for the periodic reporting and analysis of company experience to validate the continued use of such assumptions, as described in the Section ____.

2. The Manual will specify the requirements for an independent annual actuarial review of such assumptions and methods as described in Section _____.
3. The Manual will outline the required information and documentation to be provided by the company that will enable the Commissioner to monitor and assess Principles-based reserves, as described in Section _____.

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