



# AMERICAN ACADEMY *of* ACTUARIES

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## **Summary of Changes to Model Regulation and Actuarial Guidelines Principles-Based Reserves for Life Products from the American Academy of Actuaries' Life Reserves Work Group**

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

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The Life Reserves Work Group (LRWG) has continued to refine and modify the principles-based reserving approach for life products since the prior drafts of the Model Regulation and Actuarial Guidelines were exposed for comment in December of 2006.

At the request of LHATF, the 3 documents exposed for comment at the December meeting (the Model Regulation, Guideline PBR-VAL and Guideline AG DIS) have been combined into a single document using a “requirements format” that is the common template that will be used for all requirements placed in the Valuation Manual. Thus, this draft of the LRWG proposal is now in a form that is ready to be placed in the designated section of the Valuation Manual. Please note that the template following this “requirements format” is not final, but putting the LRWG proposal into this format will provide an example of what the Valuation Manual might look like.

**The LRWG requests that LHATF expose for comment this combined draft at the March meeting.**

The changes needed to convert the December drafts to this new format for the Valuation Manual include:

- 1) References to “this regulation” or “this guideline” have been replaced with “these requirements”.
- 2) The “Authority”, “Scope” and “Effective Date” sections, along with the definition of a “Principles-based Approach” in the “Purpose” section that were in the Model Regulation have been removed, since these items will be addressed elsewhere in the Valuation Manual.
- 3) The “Reporting of Experience” section that was in the Model Regulation has also been removed since this will be addressed by the proposed changes to the Standard Valuation Law.
- 4) “Sections” have been renamed “Subsections”
- 5) Duplicative wording was eliminated (i.e., wording that was in both the Model Reg and the Guidelines).

Major changes compared to the December drafts include:

- 1) Changes to the Guiding Principles in Subsection 2:
  - a) A drafting note was added to Principle 1 that lists the types of risks that are not required to be included in the reserve calculation.
  - b) A new Principle was added (Principle 2) to require that all Risk Factors included in the company’s risk assessment and evaluation processes shall be reflected in the reserve methodology (with exceptions if certain conditions are met).
  - c) Expanded Principle 5 (which addresses the determination of assumption margins) to include a reference to the aggregate impact of all margins.
- 2) “Best Estimate” and “Prudent Best Estimate” have been changed to “Anticipated Experience” and “Prudent Estimate,” respectively, throughout the document.
- 3) The requirement to use a prescribed credibility method for blending mortality experience with an Industry Table (e.g., the Canadian Normalization Method) was replaced with a requirement that allows the actuary to select the credibility method, but the credibility method must meet certain conditions. Also, an approach to grade the mortality experience into the industry mortality table was added. (Subsection 7D4).
- 4) The requirements on modeling derivative instruments and derivative programs, including hedging strategies, was revised and streamlined (Subsections 5(E)(8) and 13(D)(2)(f), and terminology consistent with these changes are reflected throughout the document.

- 5) The requirements to determine policyholder behavior assumptions (subsection 9) were:
- Streamlined to eliminate duplicative wording that, subject to adoption by the ASB, is anticipated to be in the new PBR ASOP; and
  - Reorganized to add clarity to the requirements
- 6) A new element was added in the calculation of the final Reported Reserve (Subsection 5I) called the “Provision for Model Understatement” to reflect the aggregate impact of material approximations, simplifying assumptions or simplified techniques used in the Cash Flow Model.
- 7) A new term called the “Standalone Stochastic Reserve” was added to clarify the application of the stochastic modeling exclusion (Subsection 5H5).
- 8) The table that provides a reconciliation of the allocated expenses used in the reserve calculation to the expenses reported in Exhibit 2 and 3 of the annual statement is no longer a required disclosure item.