



AMERICAN ACADEMY *of* ACTUARIES

Principles-Based Valuation Review Opinion Draft Model Regulation From the American Academy of Actuaries' Principle-based Review and Governance Work Group

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

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The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

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The Principles-based Review and Governance Work Group would also like to acknowledge the work of Deborah Whitmore, CPA.

PRINCIPLES-BASED VALUATION REVIEW OPINION DRAFT MODEL REGULATION

Table of Contents

Section 1.	Purpose
Section 2.	Authority
Section 3.	Scope
Section 4.	Definitions
Section 5.	General Requirements for Filing
Section 6.	Designation and Qualification of PBA Review Actuary
Section 7.	PBA Review Opinion
Section 8.	PBA Report and Documentation
Section 9.	Effective Date

Section 1. Purpose

The purpose of this regulation is to prescribe:

- A. Requirements for a PBA (principles-based approach/valuation) review opinion of a valuation performed under a principles-based valuation per the Standard Valuation Law and applicable regulations; and
- B. Rules applicable to the appointment of a PBA Review Actuary.

Such a review opinion is intended to provide Company management, the Company’s board of directors, insurance regulators, and the Company’s auditors with a confidential, independent review of the subjective elements of a principles-based valuation.

[Drafting Note: This regulation applies only to PBA life reserves at this time. It is anticipated that this will be extended to PBA capital later]

Section 2. Authority

This regulation is issued under the authority of Section **[insert applicable section, generally the state’s SVL]** of the Insurance Laws of **[insert state]**.

[Drafting Note: This regulation presumes that changes to the SVL have been adopted that permits the use of the principles-based approach valuation standard defined by this regulation.]

Section 3. Scope

This regulation shall apply to all life insurance companies and fraternal benefit societies doing business in this State and to all life insurance companies and fraternal benefit societies which are authorized to reinsure life insurance, annuities or accident and health insurance business in this State. The PBA review opinion required by this regulation applies to all valuations performed under a principles-based valuation per the Standard Valuation Law. Such a review opinion shall result from an independent evaluation of the professional judgment in the PBA valuation. The review does not apply to non-PBA valuations or to the asset adequacy analysis for the PBA valuation.

This regulation shall be applicable to all annual statements filed with the office of the Commissioner after the effective date of this regulation.

Section 4. Definitions

A Actuarial Standards of Practice

“Actuarial Standards of Practice” are standards of actuarial practice promulgated by the Actuarial Standards Board.

B Annual Statement

“Annual Statement” means that statement required by Section **[insert applicable section]** of the Insurance Law to be filed by the Company with the office of the Commissioner annually.

C Appointed Actuary

“Appointed Actuary” means any individual who is appointed or retained in accordance with the requirements set forth in the Actuarial Opinion and Memorandum Regulation (AOMR) to provide the actuarial opinion and supporting memorandum as required by the Standard Valuation Law.

D Commissioner

“Commissioner” [Director, Superintendent, Supervisor] means the Insurance Commissioner [Director, Superintendent] of this State.

E Company

“Company” means a life insurance Company, fraternal benefit society or reinsurer subject to the provisions of this regulation.

F PBA Review Actuary

“PBA Review Actuary” means an independent and qualified actuary who is retained by the board of directors of the Company or its designee to prepare a PBA review opinion as required by this regulation.

G PBA Review Opinion

“PBA Review Opinion” means an independent evaluation of the professional judgment expressed with respect to valuations performed under a principles-based approach per the Standard Valuation Law and applicable regulation.

Section 5. General Requirements Related to Filing

- A. Company shall file within 30 days following the filing of an Annual Statement, a PBA Review Opinion that covers all PBA valuations in the Company to the Commissioner where the Company is licensed. This opinion shall be kept confidential.
- B. Upon written request by the Company, the Commissioner from the domiciliary state may grant an extension of the date for submission of the PBA Review Opinion.
- C. The PBA Review Opinion will cover valuations performed under a principles-based valuation per the Standard Valuation Law and shall identify specifically, by list, the reserves by product type and amount to which the PBA review opinion applies in such a way that they can be associated with the reserves reported in the Company’s Annual Statement filing.
- D. The PBA Review Actuary shall support the PBA Review Opinion by a PBA Review Report, which shall be kept confidential and available upon request of the Commissioner(s).
- E. The PBA Review Actuary shall maintain documentation, which shall be kept confidential and made available upon request to Commissioner(s).
- F. The PBA Review Actuary will immediately notify the domiciliary Commissioner, with a copy to the Company, if, during the course of the analysis and review done in order to prepare the PBA Review Opinion, the PBA Review Actuary identifies a material issue with a valuation performed under a principles-based approach that cannot be satisfactorily resolved with the Company before the filing date of the Annual Statement. Such notification will specify the nature of the problem and the differences that gave rise to the issue.
- G. The confidentiality definition that applies to the PBA Review Opinion, PBA Review Report and supporting documentation is as prescribed in the Standard Valuation Law Section [insert applicable section] that applies to the Actuarial Memorandum.

Section 6. Designation and Qualification of PBA Review Actuary

- A. The Company shall file with the domiciliary Commissioner a written notice no less than six (6) months before the latest date on which the PBA Review Opinion is to be filed of the name, title, and the firm of the actuary retained and terms of retention as a PBA Review Actuary as set forth in this regulation. Once notice is furnished, no further notice regarding designation is required unless there is a change in the designation.
- B. The Company shall obtain a letter from the PBA Review Actuary accepting the assignment and file a copy with the Commissioner of its state of domicile. Such letter will indicate that the PBA Review Actuary is independent and qualified.
- C. If any actuary retained as a PBA Review Actuary replaces a previously retained actuary, the notice shall so state and give the reasons for replacement.

[Drafting Note: Code of Professional Conduct, Annotation 10-5 requires the previous PBA review actuary to discuss and share documentation with the newly appointed PBA Review Actuary. The Code also contains additional guidance regarding the interaction between the previous and newly appointed PBA Review Actuary.]

- D. The domiciliary Commissioner has (the) right, within thirty (30) days of receipt of such notice of designation or replacement, to reject the Company's choice for PBA Review Actuary if, in the opinion of the Commissioner, one of the requirements that the actuary be qualified and independent has not been satisfied.
- E. The Company shall have an engagement agreement with the PBA review actuary specifying the terms and conditions of employment. This engagement agreement shall be separate from other assignments performed by the PBA review actuary or by his or her Company.
[Open Issue: whether there should be a single PBA review opinion or multiple PBA review opinion is still under study]
- F. The PBA Review Actuary must be qualified to perform the review. The PBA reviewer must satisfy the qualification requirements for appointed actuary as specified in the Actuarial Opinion and Memorandum Regulation and by the American Academy of Actuaries, including being a member of the American Academy of Actuaries (MAAA).
- G. The PBA Review Actuary shall be independent of the work he or she is reviewing. In general, the PBA Review Actuary cannot function in the role of Company management, cannot participate in the work being reviewed, and cannot serve in an advocacy role for the Company. In addition, the PBA Review Actuary:

- (1) shall not have been employed by the Company or an affiliate of the Company in the three years preceding the date of valuation;
- (2) shall not be an employee of the same consulting firm or audit firm as the appointed actuary;
- (3) shall not have any material financial interests as a shareholder or other financial interests other than as a policyholder, beneficiary, or insured;
- (4) shall not provide a PBA review opinion for up to five consecutive years. After terminating the role of the reviewing actuary, such actuary shall not be reappointed for five years; and

[Drafting Note: The lead (or coordinating) PBA review actuary (having primary responsibility for the review) may not act in that capacity for more than five (5) consecutive years for the same Company. However, a firm may continue in that capacity with a new lead PBA review actuary.]

- (5) shall have no unresolved conflict of interest as described in the Code of Professional Conduct adopted by the American Academy of Actuaries.

- H. The domiciliary Commissioner shall have the authority to waive any requirement for designation, retention, or replacement of a PBA Review Actuary in circumstances that require such waiver.

[Drafting Note: This is intended to very broadly address situations where the timing of an appointment cannot be met when, for example, a PBA Review Actuary must be replaced because of death or inability to perform for medical or other reasons after retention. It might also be used in situations where there is a temporary insufficient supply of independent qualified actuaries available.]

[Open Issue: Academy RIGPWG recommends that both auditing actuaries (those associated with the firm that also performs audits for the same client) and consulting actuaries be permitted to perform PBA reviews. The reasons that the Academy RIGPWG recommends the auditing actuaries be allowed to perform the PBA review are:

- *There is no independence issue for the auditing actuaries since they are auditing/reviewing the appointed actuary's PBA work and will not be in the position of reviewing their own work.*
- *According to the Sarbanes-Oxley Act (SOX) and the current proposed revisions to the Model Audit Rule, the Board/Audit Committee must also pre-approve any services by the audit firm beyond the scope of the audit. We also recommend a separate engagement letter to separate out the audit and the PBA review assignment.*
- *In the case where the auditing actuary also performs the PBA review, there will be considerable overlap in the work. Therefore, there is an element of efficiency and savings.*
- *If we restrict the auditors from performing the PBA review because they also do audits, we may need to restrict any consultant that has ongoing consulting projects with the Company. Both restrictions will significantly limit the pool of qualified PBA review actuaries, which is critical to the success of the PBA review.*
- *It is critical to have a pool of qualified actuaries to perform the PBA review. Limiting this pool will have an adverse impact on the success of the PBA review.*

This is an open issue for LHATF- whether or not the auditing actuaries can perform the PBA Review]

Section 7. PBA Review Opinion

A. General Description

The PBA Review Opinion submitted in accordance with this Section shall consist of:

- (1) A paragraph identifying the PBA Reviewing Actuary and his or her qualifications (see Section 6);
- (2) A scope paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the PBA reviewing actuary's work, including a tabulation delineating the principles-based approach reserves and related actuarial items which have been examined;
- (3) A reliance paragraph describing those areas, if any, where the PBA Review Actuary has relied on other experts in reviewing data, procedures or assumptions;
- (4) An opinion paragraph expressing the PBA Reviewing Actuary's opinion with respect to the subjective judgment expressed in the PBA valuation regarding the principles-based approach reserves identified;
- (5) One or more additional paragraphs may be needed in individual Company cases to further qualify the review, including but not limited to:
 - (a) If the PBA Review Actuary considers it necessary to state a qualification of his or her opinion;
 - (b) If the PBA Review Actuary chooses to add a paragraph briefly describing any special circumstances; which form the basis for the PBA review opinion.

B. Recommended Language

The following paragraphs are to be included in the PBA Review Opinion. The language may be modified as needed to meet the circumstances of a particular case, but the PBA Review Actuary should use language that clearly expresses his or her professional judgment. However, the opinion shall retain all substantive aspects of the language provided in this Section.

- (1) The opening paragraph should generally indicate the PBA Review Actuary’s Company affiliation and his or her qualifications to sign the opinion. The opening paragraph should include a statement such as:

“I, [name], a member of the American Academy of Actuaries (Academy), am associated with the firm of [name of firm]. I have been retained by the authority of, the board of directors of [name of Company] to render this opinion as stated in the letter to the Commissioner dated [insert date]. I meet the Academy qualification standards for rendering the opinion, am familiar with the valuation regulatory requirements and the Actuarial Standards of Practice applicable to the PBA valuation.”

[Drafting Note: There will be an ASOP developed for the PBA review opinion.]

- (2) The scope paragraph should include a statement in substance as follows:

“I have examined the actuarial risk analysis, actuarial assumptions, methods, modeling and compliance used in determining PBA reserves and related actuarial items listed below, as shown in the annual statement of the Company, as prepared for filing with state regulatory officials, as of December 31, [insert year]. Tabulated below are those PBA reserves and related actuarial items that have been subject to this review.

[A tabulation of the reserves included in the valuation performed under a principles-based approach and upon which the opinion is being expressed should be included here.]

“Such examination included: an evaluation of the material risks covered by the reserves; the reserve methods used; the reasonableness of models employed; the supportability of the reserve assumptions and margins; and application of all relevant laws, regulations, and actuarial standards of practice.”

[Drafting Note: It is recognized that both the Company and PB Review certification role are introducing new methods and perspectives into the valuation process. As such, there will be an expansion of actuarial practice and review that will include items not previously focused on such as feedback loops and defined sets of actuarial principles. Both recognize that one of the key reasons for allowing flexibility in best estimates and/or margins is that a PBA approach is there to allow a better and better reserve estimate over time. Actuarial practice and review would also lead to statements that, a “consideration of the processes used (or that will be used) to capture Company experience for the future evaluation of the reasonableness of current judgment based assumptions” and that “the work was done in accordance with the set of principles stated in the underlying requirements for setting principle based reserves.”]

- (3) The opinion paragraph should include a statement in substance as follows:

“I have reviewed the reserves and related actuarial items calculated in accordance with a valuation performed under a principles-based valuation, listed above, as shown in the annual statement of [name of the Company], as prepared by its appointed actuary for filing with the Commissioner, as of December 31, [year] and in my opinion:

- (a) All quantifiable material risks are considered;
- (b) The methods used are appropriate;
- (c) The models used are reasonable for the purpose;
- (d) The assumptions used are supportable;
- (e) The margins in the reserves are supportable; and
- (f) The requirements of the insurance law and regulation of the state of [insert state of domicile] and applicable Actuarial Standards of Practice have been satisfied.

The actuarial methods, considerations and analyses used in forming my opinion conform to the appropriate Actuarial Standards of Practice as promulgated by the Actuarial Standards Board, which standards form the basis of this statement of opinion.

This opinion is updated annually as required by statute.

The impact of unanticipated events subsequent to the date of this opinion is beyond the scope of this opinion. This opinion addresses the reasonable application of actuarial judgment in the calculation of reserves as prescribed in a valuation performed under a principles-based valuation. It is not an opinion that such reserves are adequate to meet all future liability obligations of the Company.”

Name of PBA Review Actuary

Signature of PBA Review Actuary

Company of PBA Review Actuary

Address of PBA Review Actuary

Telephone Number of PBA Review Actuary

Date

C. Adverse Opinions

If the PBA Review Actuary is unable to form an opinion, he/she shall refuse to issue a PBA review opinion. If the PBA Review Actuary’s opinion is adverse or qualified, then he or she shall issue an adverse or qualified PBA Review Opinion explicitly stating the reasons for such an opinion. This statement should follow the scope paragraph and precede the opinion paragraph.

D. Reliance on Information Furnished by Other Persons

The PBA Review Actuary may rely on the documentation furnished by the Company, such as the appointed actuary’s memorandum and/or PBA certification. The PBA Review Opinion shall include a statement such as the following:

“I have relied on the [e.g., actuarial memorandum, PBA certifications] from [name], [title], [Company] in conjunction with forming my opinion. I have reviewed the information relied upon for reasonableness.”

If the PBA Review Actuary relies on other reviewers for a portion of the PBA Review Opinion, he or she shall include a statement such as the following:

“I have relied on [name], [title], [Company] for certain critical aspects of analysis [e.g., stochastic process and modeling; or annuity or long-term care valuation] performed in conjunction with forming my opinion. I have reviewed the information relied upon for reasonableness.”

In addition, the persons on whom the PBA Review Actuary relies must provide a statement that identifies the items on which the person is providing information that is consistent with the requirement in this section. This reliance statement shall include the name, signature, title, Company, address and telephone number of the person rendering the reliance, as well as the date on which it is signed.

Section 8. PBA Report and Documentation

A. Any Company required to file a PBA Review Opinion pursuant to this regulation shall require the PBA Review Actuary to make available for review by Commissioners, the PBA Review Report and all documentation prepared in the conduct of the PBA review, and any communications related to the PBA review between the PBA reviewer and

the Company. The Company shall require that the PBA Review Actuary retain the PBA review report and PBA review documentation and communications until the insurance department has filed a report on examination covering the period of the PBA valuation but no longer than seven (7) years from the date of the corresponding PBA review opinion.

B. The PBA Review Actuary shall prepare a PBA Review Report to be filed with the Company's board of directors. The PBA Review Report shall cover the following:

- (1) Describe the extent of the work done by the PBA Review Actuary:
 - (a) A description of the scope and limitations of the review;
 - (b) A description of the extent to which the PBA Review Actuary had access to the relevant data, information, reports, staff, contractors, and appointed actuary and other valuation actuaries;
 - (c) A description of the extent of reliance on documentation furnished by the Company; and
 - (d) A description of procedures and approaches used for the PBA review.
- (2) Discuss how the reviewer reached his or her conclusions.
- (3) Disclose findings, concerns, recommendations.
- (4) Assess that the appointed actuary has followed all relevant laws, regulations, Actuarial Guidelines, and Actuarial Standards of Practice related to the subjective nature of the PBA valuation.
- (5) Assess the quality and sufficiency of the PBA valuation report.
- (6) Describe any remaining differences of opinion between the PBA reviewer and the appointed actuary.

The PBA Review Report shall include name, signature, address, phone number, Company of the PBA review actuary and date of the report.

C. Documentation is defined to be the records kept by the PBA review actuary of the procedures followed, the analyses performed, the information obtained, and the conclusions reached pertinent to the PBA review opinion and PBA review report. It may include PBA review planning documentation, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of Company documents and schedules or commentaries prepared or obtained by the PBA review actuary in the course of his or her review of the PBA valuation of the Company. The documentation provides the trail to support the formation of the PBA review opinion and PBA review report.

D. The PBA review report, documentation, and any communications related to the PBA review may be retained by the Commissioner. All PBA review reports, documentation and communications obtained shall be afforded with confidentiality.

Section 9. Effective Date

This regulation is effective with respect to all reserves calculated per the requirements of a valuation performed under a principles-based valuation per the Standard Valuation Law **[insert applicable section]**.