Life Actuarial (A) Task Force/ Health Actuarial (B) Task Force
Amendment Proposal Form*

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

   Dave Neve, chairperson of American Academy of Actuaries Life Financial Soundness/Risk Management Committee. PBR Review and Updating Process.

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:

   VALUATION MANUAL – VM-00 September 2011 Proposed Draft

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.)

   See attached document

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

   A well-conceived and designed PBR Review and Updating Process (formerly referred to as a "PBR Feedback Loop") is essential to ensure that there is an ongoing evaluation of the effectiveness of the PBR methodology and prescribed assumptions defined in the Valuation Manual. This proposal provides a summary of the importance, purpose, and goals of such a process. We are proposing that this summary be placed in the VM-00, immediately before the "Process For Updating Valuation Manual" section of VM-00.

* 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:

Dates: Received	Reviewed by Staff	Distributed	Considered
Notes:			

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Draft: 9/8/11

The NAIC solicits comments on this draft. Comments should be sent to John Engelhardt, NAIC, at JEngelha@naic.org

VALUATION MANUAL

September 2011
Proposed Draft

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I. INTRODUCTION

AUTHORITY AND APPLICABILITY

The Valuation Manual sets forth the minimum reserve and related requirements for jurisdictions where the Standard Valuation Law, as amended by the NAIC in 2009, or legislation including substantially similar terms and provisions has been enacted by jurisdictions, and this Valuation Manual (VM) are operative. The NAIC Model Standard Valuation Law ("Standard Valuation Law" or "SVL") is provided in VM-5 of this Valuation Manual. The reserve requirements in the Valuation Manual satisfy the minimum valuation requirements of the Standard Valuation Law.

Requirements in the Valuation Manual are applicable to life insurance contracts, accident and health insurance contracts and deposit-type contracts as provided in the Valuation Manual. These contracts include the meaning provided by Statutory Statement of Accounting Principle (SSAP) 50 as found in the NAIC Accounting Practices and Procedures Manual (APPM). Annuity contracts are therefore included within the term life insurance contracts unless specifically indicated otherwise in this Valuation Manual.

Minimum reserve requirements are provided in this Valuation Manual for contracts issued on or after the Valuation Manual operative date of [insert the initial VM operative date]. Other requirements are applicable as provided pursuant to the SVL and this Valuation Manual.

BACKGROUND

As insurance products have increased in their complexity, and as companies have developed new and innovative product designs that change their risk profile, the need to develop new valuation methodologies or revisions to existing requirements to address these changes has led to the development of the Valuation Manual. In addition, the Valuation Manual addresses the need to develop a valuation standard that enhances uniformity among the principle-based valuation requirements across states and insurance departments. Finally, the Valuation Manual defines a process to facilitate future changes in valuation requirements on a more uniform, timely and efficient basis.

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

1. To consolidate into one document the minimum reserve requirements for life insurance contracts, accident and health insurance contracts and deposit-type contracts pursuant to the SVL, including those products subject to principle-based valuation requirements and those not subject to principle-based valuation requirements.

2. To promote uniformity among states' valuation requirements.

3. To provide for an efficient, consistent, and timely process to update valuation requirements as the need arises.

4. To mandate and facilitate the specific reporting requirements of experience data.

5. To enhance industry compliance with the MM/DD/20XX revisions to the SVL, as adopted in various states.

DESCRIPTION OF VALUATION MANUAL

The Valuation Manual contains five sections which provide requirements covered in Authority and Applicability above, and which discuss principles and concepts underlying these requirements.

1. Section I is an introductory section that includes the general concepts underlying the reserve requirements in the Valuation Manual.

2. Section II summarizes the minimum reserve requirements which apply to a product or type of product including which products or categories of products are subject to principle-based valuation requirements and documentation. As minimum reserve requirements are developed for various products or categories of

products, those requirements will be incorporated into this section. The applicability of the minimum reserve requirements to particular products will be clarified in the appropriate subsection. For example, the minimum reserve requirements that apply to a life insurance product will be identified in the subsection addressing life insurance reserve requirements.

3. Section III sets forth the requirements for the actuarial opinion and memorandum and the principle-based report.

4. Section IV sets forth the experience reporting requirements.

5. Section V contains Valuation Manual minimum standards. These standards contain the specific requirements that are referenced in Sections II - IV.

OPERATIVE DATE OF VALUATION MANUAL

The requirements in the Valuation Manual become operative pursuant to Section 11 of the SVL.

PBR REVIEW AND UPDATING PROCESS

A well-conceived and designed PBR Review and Updating process is needed to ensure ongoing evaluation of the effectiveness of the PBR methodology and prescribed assumptions defined in this Manual. This process will provide on-going feedback to regulators for the purpose of updating, improving, enhancing, and modifying the PBR reserve requirements. These changes are necessary due to, for example, removal/revision of regulatory “guardrails” (i.e., provisions for conservatism that are intended to be temporary that have been incorporated into the initial PBR methodology), future improvements in cash flow modeling techniques, future development of new policy benefits and guarantees, future changes in assumptions due to emerging experience, improved methods to assess risk, etc. This review and updating process should include requests for comments and suggestions from interested parties.

A key element of the PBR Review and Updating Process is the need for state insurance regulators to obtain the necessary expertise, resources, data, and tools to effectively review the stochastic models that are required in the Valuation Manual for products subject to PBR requirements. This will allow regulators to better understand the impact of the guardrails and prescriptive elements on the stochastic component of the reserve, and also decrease dependence on the deterministic floor to ensure a level of conservatism appropriate for statutory reporting.

Goals for the PBR Review and Updating Process include achieving consistency in regulatory requirements among states, evolving from prescribed elements to principle-based approaches, and increasing confidence in the appropriateness of the results. This PBR Review and Updating Process is essential for the Valuation Manual to be effective and ultimately achieve the objectives the NAIC intends.

PROCESS FOR UPDATING VALUATION MANUAL

The NAIC is responsible for the ongoing maintenance of the Valuation Manual. The Life and Health Actuarial Task Force (LHATF) is charged with developing changes to the Valuation Manual for NAIC adoption. Review of the PBR methodology and prescribed elements (as described in the preceding section) shall be undertaken no less frequently than every three years to ensure that needed changes to the Valuation Manual are made on a timely basis.

Any changes must conform to guidelines, which may be provided in a policy statement(s), developed by the NAIC to support joint use of reserve and other requirements as referenced by the *Accounting Practices and Procedures Manual*, the Valuation Manual and the Standard Valuation Law, etc.

Changes must be consistent with existing model laws or with projects which have received Executive Committee approval to develop new model laws and to the extent the actuarial requirements could have an impact on accounting and reporting guidance in the *Accounting Practices and Procedures Manual* proposed changes must be reviewed by the Statutory Accounting Principles Working Group (SAPWG) for consistency with the *Accounting Practices and Procedures Manual.*

The Life and Health Actuarial Task Force is charged with the maintenance of the Valuation Manual. The Task Force or its staff support will prepare a summary recommendation that will include an analysis of the impact of proposed changes on reserves, the consumer and the industry, including any other impact, based on size of company.

LHATF staff support will work with SAPWG staff support to provide a summary and (*or that)* will also include an agenda submission form which will recommend changes to the *Accounting Practices and Procedures Manual*, if needed, to be consistent with the proposed change. As practical the Accounting Practices and Procedures Manual will reference appropriate Valuation Manual requirements with the same implementation date as the Valuation Manual.

> If SAPWG responds that the proposed changes to the Valuation Manual are inconsistent with the authoritative guidance in the *Accounting Practices and Procedures Manual*, LHATF will work with SAPWG to resolve such inconsistencies.

In the event that SAPWG and LHATF are unable to resolve such inconsistencies, a joint subgroup will be formed to resolve the particular issue. Both groups shall send an equal number of knowledgeable representatives to the joint subgroup (suggest 3-5_representatives each) and report back on a recommended resolution. The representatives shall be appointed by the Chair of the Life and Health Actuarial Task Force and the Chair of the Statutory Accounting Principles Working Group. The Subgroup(s) shall provide regular updates on the progress of the specified issue. Neither group should take action, until the subgroup has a recommended resolution.

Both the Statutory Accounting Principles Working Group and the Life and Health Actuarial Task Force will review proposed Valuation Manual changes for conformance with these guidelines and provide written conclusions and approvals. When both the Statutory Accounting Principles Working Group and the Life and Health Actuarial Task Force conclude the proposed Valuation Manual changes are in conformance with these guidelines and provide approval, the Valuation Manual changes will then be forwarded to the appropriate parent committees or task forces prior to consideration of NAIC adoption by Executive and Plenary.

Guidelines or a policy statement may be developed to expedite the adoption process of LHATF and SAPWG for those Valuation Manual changes where an emergency situation is present as defined by such guidelines.

Valuation Manual changes must be adopted by the NAIC Executive and Plenary at least six months before becoming effective. The following January 1 will generally be the effective date unless otherwise specified in the changes adopted.

OVERVIEW OF RESERVE CONCEPTS

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. .

1. 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.

2.

A principle-based reserve valuation must only reflect risks

1. Associated with the policies or contracts being valued, or their supporting assets; and
2. Determined capable of materially affecting the reserve.

Risks not to be included in reserves are those of a general business nature, those that are not associated with the policies or contracts being valued, or those that are best viewed from the company perspective as opposed to the policy or contract perspective. These risks may involve the need for a liability separate from the reserve, or may be provided for in capital and surplus.

Since no list can be comprehensive and applicable to all types of products, this section of the_Manual provides examples of the general approach to the determination of the meaning of “associated with the policies or contracts” while recognizing that each relevant section of the Manual will deal with this issue from the perspective of the products subject to that section. Examples of risks to be included in a principle-based valuation include risks 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.

CORPORATE GOVERNANCE REQUIREMENTS FOR PRINCIPLE-BASED RESERVES

The requirements found in VM-Appendix G (VM-G) provide corporate governance requirements applicable to products subject to Principle-Based Reserves as specified in this Valuation Manual. VM-G applies to products issued prior to the operative date of the Valuation Manual that are subject to Actuarial Guideline XLIII in VM-Appendix C in addition to those products subject to VM-21 issued on or after the operative date of Valuation Manual.

II. RESERVE REQUIREMENTS

This section provides the minimum reserve requirements by type of product. All reserve requirements provided by this section relate to business issued on or after the operative date of the Valuation Manual. All reserves must be developed in a manner consistent with the requirements and concepts stated in the Overview of Reserve Concepts in Section I of the Valuation Manual.

LIFE INSURANCE PRODUCTS

1. This subsection establishes reserve requirements for all contracts issued on and after the operative date of the Valuation Manual_which are classified as life contracts defined in the *Accounting Practices and Procedures Manual*, Statutory Statement of Accounting Principle 50 (SSAP 50), with the exception of annuity contracts and credit life contracts. Minimum reserve requirements for annuity contracts and credit life contracts are provided in other subsections of the Valuation Manual.

2. Minimum reserve requirements for variable and non-variable individual life contracts, excluding preneed life contracts and credit life contracts, are provided by VM-20 except for election of the transition period in paragraph 3 of this subsection.

   Minimum reserve requirements of VM-20 are considered “Principle-based Reserve (PBR)” requirements for purposes of the Valuation Manual and VM-31 unless VM-20 or other requirements apply only the net premium reserve method or applicable requirements in VM-A and VM-C.

   Minimum reserve requirements for life contracts not subject to VM-20 are those pursuant to applicable requirements in VM-A and VM-C.

3. A company may elect to establish minimum reserves pursuant to applicable requirements in VM-A and VM-C for business otherwise subject to VM-20 requirements and issued during the first three years following the operative date of the Valuation Manual. If a company during the three years elects to apply VM-20 to a block of such business then a company must continue to apply the requirements of VM-20 for future issues of this business.

ANNUITY PRODUCTS

1. This subsection establishes reserve requirements for all contracts classified as annuity contracts defined in the *Accounting Practices and Procedures Manual,* Statutory Statement of Accounting Principle 50 (SSAP 50).

2. Minimum reserve requirements for variable annuity contracts and similar business, specified in VM-21, shall be those provided by VM-21. The minimum reserve requirements of VM-21 are considered “Principle-based Reserve (PBR)” requirements for purposes of the Valuation Manual.

3. Minimum reserve requirements for fixed annuity contracts are those requirements as found in Appendix A and C of the Valuation Manual (VM-A and VM-C) as applicable.

DEPOSIT-TYPE CONTRACTS

1. This subsection establishes reserve requirements for all contracts classified as deposit-type contracts defined in the *Accounting Practices and Procedures Manual*, Statutory Statement of Accounting Principle 50 (SSAP 50).

2. Minimum reserve requirements for deposit-type contracts are those requirements as found in Appendix A and C of the Valuation Manual (VM-A and VM-C) as applicable.

HEALTH INSURANCE PRODUCTS

1. This subsection establishes reserve requirements for all contracts classified as health contracts defined in the *Accounting Practices and Procedures Manual*, Statutory Statement of Accounting Principle 50 (SSAP 50).

2. Minimum reserve requirements for accident and health insurance contracts, other than Credit Disability, are those requirements provided by VM-25 and VM-A and VM-C requirements, as applicable.

CREDIT LIFE AND DISABILITY PRODUCTS

1. This subsection establishes reserve requirements for all credit life, credit disability products and other credit-related products defined as follows:

2. "Credit life insurance" means insurance on a debtor or debtors, pursuant to or in connection with a specific loan or other credit transaction, to provide for satisfaction of a debt, in whole or in part, upon the death of an insured debtor.

   Credit life insurance does NOT include:

   a. Insurance written in connection with a credit transaction that is:

      i. Secured by a first mortgage or deed of trust; and

      ii. Made to finance the purchase of real property or the construction of a dwelling thereon, or to refinance a prior credit transaction made for such a purpose;

   b. Insurance sold as an isolated transaction on the part of the insurer and not related to an agreement or a plan for insuring debtors of the creditor.

   c. Insurance on accounts receivable.

3. "Credit disability insurance" means insurance on a debtor or debtors to or in connection with a specific loan or other credit transaction, to provide for lump sum or periodic payments on a specific loan or other credit transaction due to the disability of the insured debtor.

4. "Other Credit-Related Insurance" means insurance on a debtor or debtors, pursuant to or in connection with a specific loan or other credit transaction, including a real estate secured loan, to provide for satisfaction of a debt, in whole or in part, upon the death or disability of an insured debtor.

   a. Other Credit-Related insurance includes insurance written in connection with a credit transaction that is:

      i. Secured by a first mortgage or deed of trust written as credit insurance, debtor group insurance or group mortgage insurance; and

      ii. Made to finance the purchase of real property or the construction of a dwelling thereon, or to refinance a prior credit transaction made for such a purpose;

   b. Other Credit-Related insurance DOES NOT include:

i. Insurance sold as an isolated transaction on the part of the insurer and not related to an agreement or a plan for insuring debtors of the creditor, and

ii. Insurance on accounts receivable.

5. Minimum reserve requirements for credit life, credit disability contracts and other credit-related insurance issued on or after the operative date of the Valuation Manual are provided in VM-26. For purposes of reserves for "other credit related insurance" within VM-26, the terms "credit life insurance" and "credit disability insurance" shall include benefits provided under contracts defined herein as "other credit-related insurance."

RIDERS AND SUPPLEMENTAL BENEFITS

1. If a rider or supplemental benefit to one of the above types of products has a separately identified premium or charge, then the following apply:

   a. For supplemental benefits, e.g., Disability Waiver of Premium, Accidental Death Benefits, Convertibility or Guaranteed Insurability, the reserves may be computed separate from the base contract following the reserves requirements for that benefit;

   b. For term life insurance riders on persons other than the named insured[s] on the base policy, the reserve may be computed separate from the base policy following the reserve requirements for that benefit;

   c. For term life insurance riders on the named insured[s] on the base policy, the reserve shall be valued as part of the base policy; and

   d. For riders that enhance or modify the terms of the base contract, e.g., a secondary guarantee rider or a cash value enhancement rider, the reserve shall be valued as part of the base policy.

   e. For any riders not addressed by paragraphs 1.b through 1.d above, the reserve shall be valued as part of the base policy.

2. If a rider or supplemental benefit does not have a separately identified premium or charge, all cash flows associated with the rider or supplemental benefit must be included in the calculation of the reserve for the base policy. For example, reserves for a universal life policy with an accelerated benefit for long term care must include cash flows from the long term care benefit in determining minimum reserves in compliance with VM-20. A separate reserve is not determined for the rider or supplemental benefit.

CLAIM RESERVES

Regardless of the requirement for use of the PBR approach to policy reserves, the claim reserves, including waiver of premium claims, are not subject to PBR requirements of the Valuation Manual.

III. ACTUARIAL OPINION AND REPORT REQUIREMENTS

Requirements regarding the annual actuarial opinion and memorandum pursuant to Section 3 of the NAIC Model Standard Valuation Law (VM-5) are provided in VM-30.

PBR Report requirements applicable to products or types of products subject to principle-based reserve valuations (PBR) as specified in the Valuation Manual are provided in VM-31.

IV. EXPERIENCE REPORTING REQUIREMENTS

Experience reporting requirements are provided in VM-50. The associated experience reporting formats and additional instructions are provided in VM-51.

V. VALUATION MANUAL MINIMUM STANDARDS

This section provides the specific minimum reserve standards as referenced by the preceding sections.

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