

## **Amendment Proposal Form\*** (NAIC Research Division)

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

Bob DiRico, chair, American Academy of Actuaries' Consistency Work Group; clarify risks to be included in a principle-based valuation.
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 February 18, 2009.
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. (Please red-line it from the current version with existing changes already accepted. You may do this through an attachment.)

### **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. .

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.

~~**Drafting Note:** Is the Valuation Manual the appropriate place for these concepts?~~

~~Requirements specified by the Valuation Manual as principle based valuation requirements are deemed consistent with the following concepts:~~

- ~~1. Captures the benefits and guarantees associated with the contracts and their identifiable, quantifiable and material risks, including the 'tail risk' associated with each product 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, 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. Utilizes 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. Incorporates 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. Reflects risks and risk factors in the calculation of the principle-based valuation minimum statutory reserves and statutory RBC that may be different from one another and may change over time as products and risk measurement techniques evolve, both in a general sense and within the company's risk management processes.~~

A company using a principle-based valuation for one or more policies or contracts must establish reserves for those policies and contracts that reflect risks that arise from future events that are:

- (a) Directly related to the policies or contracts being valued, or their supporting assets; and
- (b) Determined capable of materially affecting the reserve.

Risks not to be included in reserves are those of a general business nature that are not specific to the insurance contract, and 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.

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. Examples of risks not to be included in a principle-based valuation include guaranty fund assessment risk or liability, health risk pool liability, reputation risk and fraud/theft risk.

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

The proposed wording clarifies the risks that must be included in a principle-based valuation. The list of examples given in the proposed wording is an abbreviated version of more detailed product specific examples that are included in the various sections of the Valuation Manual (and currently in AG43). We believe this clarification is needed to distinguish between risks that are to be reflected in minimum reserve requirements versus other non-reserve liabilities and RBC capital requirements. In the absence of such guidance, 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 other non-reserve liabilities or RBC requirements.

\* 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.

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NAIC Staff Comments:

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