Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Commissioner Discretion in the *Valuation Manual***

**Check (applicable entity):**

P/C Life Health

Modification of Existing SSAP

New Issue or SSAP

Interpretation

Description of Issue:

The *Valuation Manual* became operative on January 1, 2017 and is required to be used for all applicable products effective January 1, 2020. This agenda item has been drafted to maintain comparability by providing disclosures regarding the use of commissioner discretion pursuant to the *Valuation Manual*.

The Authoritative Literature section in the agenda item has examples of items that require commissioner approval in the *Valuation Manual*.The items involve making a voluntary choice between various acceptable methods, which is subject to commissioner approval. The identified instances in the *Valuation Manual* are consistent with a change in valuation basis. Examples identified may include characteristics similar to the following:

1. Voluntarily moving between different commonly accepted methods of determining an amount;
2. The change of method is generally infrequent;
3. Changing methods is a voluntary choice, not an automatic change required by the methodology;
4. Change in valuation which must be typically justified to the commissioner prior to approval*.*

Because these changes are voluntary and not required to change by the methodology, this agenda item recommends disclosing the use of commissioner discretion required for choosing between acceptable methods, consistent with a change in valuation basis.

Existing Authoritative Literature:

*SSAP No. 3—Accounting Changes and Corrections of Errors*

Change in Accounting Principle

3. A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.

4. A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.

5. The cumulative1 effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

1 If additional changes are identified in subsequent quarters of a fiscal year related to a change in accounting principles recognized initially during the first quarter, such changes shall be considered part of the cumulative effect of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods. For example, adjustments to an amount recorded as of January 1, 2001, would be recorded as changes in accounting principle rather than corrections of an error through the period of 2001.

*SSAP No. 51R—Life Contracts*

1. For life and annuity policies issued on or after the operative date of the *Valuation Manual*, reserves shall use the requirements of the *Valuation Manual*. As required by Appendix A-820, reserves are required to be determined using the methodologies and processes described in the *Valuation Manual*. For policies unable to meet the *Valuation Manual* criteria for exemption from deterministic or stochastic reserves, the *Valuation Manual* supplements formulaic life insurance policy reserve methodologies with more advanced deterministic and stochastic reserve methodologies to produce reserves that better reflect company experience, possible economic conditions and inherent policy risks.

Change In Valuation Basis

36. A change in valuation basis for reserves determined under paragraphs 18-21, except for reserves defined under Actuarial Guideline XLIII—CARVM: For Variable Annuities (AG 43), as detailed in Appendix C of this Manual, shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

37. Changes in reserves developed under paragraph 22 or AG 43 shall be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.

a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in Valuation Manual tables, such as industry valuation basic tables, asset spread tables and default cost tables.

b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology.

38. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line) rather than as a part of the reserve change recognized in the summary of operations.

39. The impact of a change in valuation basis on surplus is based on the difference between the reported reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38 of this statement, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies inforce for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. The Valuation Manual is effective prospectively for policies written on or after the operative date. Therefore, upon the initial prospective adoption of principle-based reserving, the change in valuation basis reflected as an adjustment to surplus will be zero. After initial adoption of the Valuation Manual, changes in valuation basis will need to be evaluated to determine the amount of any surplus adjustments.

*SSAP No. 52—Deposit-Type Contracts*

Change In Valuation Basis

14. A change in valuation basis shall be defined as a change in the interest rate assumption or other factor affecting the reserve computation of policies inforce and meets the definition of an accounting change as defined *in SSAP No. 3—Accounting Changes and Corrections of Errors*. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a specific transition that allows for grading.

*SSAP No. 54R—Individual and Group Accident and Health Contracts*

1. The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820, A-822 (as applicable), the *Valuation Manual* and the actuarial guidelines found in Appendix C of this Manual (as applicable). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Change In Valuation Basis

22. A change in valuation basis shall be defined as a change in the interest rate, mortality and morbidity assumptions, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3). Changing morbidity assumptions regarding the length of claim continuance based on regularly updated credible experience as required for products subject to Actuarial Guideline XLVII—The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table (AG 47) and Actuarial Guideline L—2013 Individual Disability Income Valuation Table (AG 50) are not considered a change in valuation basis. Other uses of regularly updated credible experience required to be used for morbidity assumptions by Appendix A-010 regarding continuing claim payments are generally not considered a change in valuation basis. Consistent with SSAP No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus (under changes to surplus in the change in valuation basis annual statement line for life, accident and health, and health reporting entities) rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in this paragraph, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies inforce for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. This difference shall not be graded in over time unless this statement prescribes a new method and a specific transition that allows for grading.

The *Valuation Manual* is referenced in the following places in the *Accounting Practices and Procedures Manual:*

* *SSAP No. 51R—Life Contracts*
* *SSAP No. 54R—Individual and Group Accident and Health Contracts*
* *SSAP No, 108— Derivatives Hedging Variable Annuity Guarantees*
* *Appendix A-010: Minimum Reserve Standards for Individual and Group Health Insurance Contracts*
* *Appendix A-820: Minimum Life and Annuity Reserve Standards*
* *Appendix C- Actuarial Guidelines*-- Multiple Places

The *Valuation Manual* provides the following instances of commissioner discretion (shading added for emphasis):

**VM-20**

Section 9C3d(iii)

iii. In taking into account factors that are not recognized in the Relative Risk Tool, a company may, to the extent it can justify, adjust the industry basic tables up or down two Relative Risk Tables from that determined by application of the Relative Risk Tool. Further adjustments to reflect risk characteristics not captured within the Relative Risk Tool may be allowed upon approval by the insurance commissioner.

Section 9C5a

For valuations in which the industry basic mortality table is the 2015 VBT, determine an aggregate level of credibility following either the Limited Fluctuation Method by amount, such that the minimum probability is at least 95% with an error margin of no more than 5% or Bühlmann Empirical Bayesian Method by amount. Once chosen, the credibility method must be applied to all business subject to VM20 and requiring credibility percentages. A company seeking to change credibility methods must request and subsequently receive the approval of the insurance commissioner. The request must include the justification for the change and a demonstration of the rationale supporting the change.

**VM-21 (Note that agenda item 2019-47 addresses this exercise of discretion).**

Section 2B

These requirements apply for valuation dates on or after Jan. 1, 2020. A company may elect to phase in these requirements over a 36-month period beginning Jan. 1, 2020. A company may elect a longer phase-in period, up to seven years, with approval of the domiciliary commissioner. The election of whether to phase in and the period of phase-in must be made prior to the Dec. 31, 2020, valuation. At the company’s option, a phase-in may be terminated prior to the originally elected end of the phase-in period; the reserve would then be equal to the unadjusted reserve calculated according to the requirements of VM-21 applicable for valuation dates on or after Jan. 1, 2020. If there is a material decrease in the book of business by sale or reinsurance ceded, the company shall adjust the amount of the phase-in provision. The phase-in amount (C = R1 – R2, as described below) must be scaled down in proportion to the reduction in the excess reserve, measured on the effective transaction date as the reserve amount in excess of cash surrender value before and after the impact of the transaction. The company must obtain approval for any other modification of the remaining phase-in amount. The method to be used for the phase-in calculation is as follows

Section 2C - The Additional Standard Projection Amount

The additional standard projection amount is determined by applying one of the two standard projection methods defined in Section 6. The same method must be used for all contracts within a group of contracts that are aggregated together to determine the reserve, and the additional standard projection amount excluding any contracts whose reserve is determined using the Alternative Methodology. The company shall elect which method they will use to determine the additional standard projection amount. The company may not change that election for a future valuation without the approval of the domiciliary commissioner.

Section 3E - Alternative Methodology

For a group of variable deferred annuity contracts that contain either no guaranteed benefits or only GMDBs—i.e., no VAGLBs—the reserve may be determined using the Alternative Methodology described in Section 7 rather than using the approach described in Section 3.C and Section 3.D. However, in the event that the approach described in Section 3.C and Section 3.D has been used in prior valuations for that group of contracts, the Alternative Methodology may not be used without approval from the domiciliary commissioner.

Section 4A4a(ii)b - Modeling of Hedges

a. For a company that does not have a CDHS:

i. The company shall not consider the cash flows from any future hedge purchases or any rebalancing of existing hedge assets in its modeling.

ii. Existing hedging instruments that are currently held by the company in support of the contracts falling under the scope of these requirements shall be included in the starting assets. The hedge assets may then be considered in one of two ways:

a) Include the asset cash flows from any contractual payments and maturity values in the projection model; or

b) No hedge positions – in which case the hedge positions held on the valuation date are replaced with cash and/or other general account assets in an amount equal to the aggregate market value

of these hedge positions.

Guidance Note: If the hedge positions held on the valuation date are replaced with cash, then as with any other cash, such amounts may then be invested following the company’s investment strategy. A company may switch from method a) to method b) at any time, but it may only change from b) to a) with the approval of the domiciliary commissioner.

Section 6B2

The company shall determine the Prescribed Projections Amount by following either the CSMP Method or the CTEPA Method below. A company may not change the method used from one valuation to the next without the approval of the domiciliary commissioner

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Several updates to the *Accounting Practices and Procedures Manual* were adopted to address the operative date of the *Valuation Manual*.

* 2015-47: PBR SSAP
* 2016-10: Changes to A-820 Standard Valuation Law for Principle-based Reserving
* 2016-15: Change in Valuation Basis for Life Contracts
* 2016-34: Health *Valuation Manual* Updates
* 2016-17: A-010 Minimum Reserve Standards for Individual and Group Health Insurance Contracts

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

**Convergence with International Financial Reporting Standards (IFRS): None**

Staff Recommendation:

NAIC Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 51R—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts* and *SSAP No. 54R—Individual and Group Accident and Health Contracts* as illustrated below. The proposed disclosure notes that voluntary decisions to choose one allowable reserving methodology over another, which require commissioner approval under the *Valuation Manual* shall be reported as a change in valuation basis. As part of the coordination process with the *Valuation Manual,* the Life Actuarial (A) Task Force should also be notified of the exposure.

Proposed revisions for Spring 2020 Discussion:

*SSAP No. 51R—Life Contracts:*

Change In Valuation Basis

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*SSAP No. 52—Deposit-Type Contracts:*

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*SSAP No. 54R—Individual and Group Accident and Health Contracts:*

Change In Valuation Basis

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Staff Review Completed by:

Robin Marcotte - NAIC Staff

February 2020

**Status:**

On March 18, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 51R—Life Contracts, SSAP No. 52—Deposit-Type Contracts* and *SSAP No. 54R—Individual and Group Accident and Health Contracts*, as illustrated above, to note that voluntary decisions to choose one allowable reserving methodology over another, which requires commissioner approval under the *Valuation Manual*, shall be reported as a change in valuation basis. A notification of this exposure will be sent to the Life Actuarial (A) Task Force.This item has a comment period deadline ending May 29, 2020.

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