

**PRINCIPLES-BASED RESERVING
(EX) WORKING GROUP
OF THE NATIONAL ASSOCIATION
OF INSURANCE COMMISSIONERS**



**PRINCIPLES FOR THE NAICs
ADOPTION OF A PRINCIPLES-BASED
RESERVING APPROACH**

As of June 1, 2008

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

Purpose & Objective of Principles

This document was developed by the Principles-Based Reserving (EX) Working Group to serve as guiding principles for the NAIC's consideration of a principles-based approach for reserving. The Principles-Based Reserving (EX) Working Group was established by the Executive Committee with the following charges:

1. To serve as a coordinating body with all NAIC technical groups involved with projects related to a principles-based approach to regulation.
2. To consider policy and practice issues related to principles-based regulation for life insurance and thereafter property and casualty insurance, including but not limited to the impact on areas such as corporate governance, examination and analysis, as well as staff resources and other insurance department administrative concerns.
3. To focus on balancing theoretical approaches with effective regulatory practices to achieve desired end-results in solvency monitoring efforts, and further coordinate with NAIC leadership to provide direction to NAIC technical groups, including whether and to what degree principles-based approaches should be pursued, setting timelines for such pursuit, and ensuring other issues are addressed prior to or concurrently with implementation of principles-based approaches by the technical groups.
4. To report the status of its work to, and seek guidance from, the Executive Committee no less frequently than a quarterly basis.
5. To evaluate necessary changes to existing state insurance laws, regulations or administrative policies to effectuate a principles-based regulatory framework.

The initial focus of this Working Group has been on those activities that have been initiated by the NAIC's Life and Health Actuarial Task Force (LHATF). LHATF is the NAIC's technical body for issuing reserving guidance on life and health products. This includes not only NAIC model laws and regulations, but also actuarial guidelines. Over the years, new laws and regulations have been developed to address the ever evolving products that insurers develop. However, recently there has been an increasing need for regulators to address issues related to those laws and regulations, including issues where some companies have established reserves that are inconsistent with the intent of established actuarial guidance.

Simultaneously, insurance has become a much more global business, and some have claimed the United States regulatory environment prevents insurers from competing globally. This is based upon the belief that United States reserving requirements for life insurance products are excessive, or that they result in reserves that are far in excess of economic reality. This has led to various actions by United States insurers to unlock the value embedded in the statutory reserve through the use of offshore reinsurance or securitization transactions. Additionally, many view excessive reserves as being detrimental to the insurance consumer and the marketplace. Actuarial regulators have acknowledged that the current methodologies do not adequately address the benefits, revenues, and risk characteristics of insurance products being offered, and a more permanent, principles-based solution is needed.

For all of the above reasons, the NAIC has developed the above charges for this Working Group to consider this project more closely. Once again, the purpose and objective of this document is to outline the guiding principles for the NAIC's consideration of a principles-based approach for reserving.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

Discussion of Principles & Action Items

The Principles-Based Reserving (EX) Working Group exposed a draft of its principles at the 2007 Summer National Meeting. The principles were drafted with the intent of providing a guide for the NAIC technical groups to consider in completing any work related to the project. The initial draft also included proposed action items to better establish the expectations of the Principles-Based Reserving (EX) Working Group. The proposed principles were distributed directly to the technical groups, with a request for feedback on the principles and action items. The technical groups, as well as other parties, provided comments on the principles and action items which were accumulated and presented to the Working Group at the 2007 Fall National Meeting. The comments received have now been incorporated into this revised principles document, and subsequent to the 2007 Fall National Meeting, the focus has now shifted to the action items. This document will continue to be revised as necessary to address new items that are brought to the attention of the Working Group.

The NAIC has determined that there are two stages to this project. Stage 1 represents all deliverables that are required to be completed prior to the adoption of the project by the NAIC. The adoption of the project is largely viewed as the adoption of the changes to the Standard Valuation Law. The accompanying Valuation Manual, which provides the mechanism to move towards a principles-based approach to reserving is also considered part of Stage 1, but it is expected that it will be modified from the time that it is initially drafted and the time that it becomes effective. Stage 2 represents all deliverables that can be completed subsequent to the adoption of the Standard Valuation Law and accompanying Valuation Manual.

Definitions/Explanations

Principles-Based Valuation- Valuations that capture all benefits and guarantees associated with the contracts and their identifiable, quantifiable and material risks, including tail risk associated with each product and the funding of the risks. These valuations incorporate assumptions, risk analysis methods and models, and management techniques that are consistent with, but not necessarily identical to, those utilized within the company's overall risk assessment process.

Principles - An essential element, or requirement to the NAIC in allowing the use of a principle-based approach to reserving, and are noted as A, B, C, etc under each of the sections (e.g. I, II, etc) of this document.

Subprinciple - Represents explanatory notes that discuss the specifics of each broad principle in more depth. The subprinciples are not necessarily requirements to the NAIC in allowing the use of a principle-based approach to reserving, but should ultimately be addressed by the technical group(s) given the action item, with any recommendation on the item documented in a report to the Principles-Based Reserving (EX) Working Group. These items are noted immediately after the principles, generally in the form of a bullet.

Action Items - Items which must be considered by the NAIC technical group as set forth in the document. The technical group can ultimately suggest that no action is required on the assigned item, but this should be done so in a report to the Principles-Based Reserving (EX) Working Group. These items are noted immediately following the action item caption, usually as a number (e.g. 1, 2, 3, etc).

As noted by the Working Group previously, all NAIC technical groups which have been assigned to consider a particular issue have been asked to comment on the principles and action items. In addition, all NAIC technical groups have been asked to immediately begin considering the actions necessary for their respective areas and to begin providing updates on their work starting at the 2007 Winter National Meeting. The updates should include a status of progress as well as concerns or issues that require input

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

from the Principles-Based Reserving (EX) Working Group. The NAIC technical groups have been encouraged to reach out to members of the American Academy of Actuaries (AAA), as they have agreed to assist the NAIC on this very important project.

Scope

As noted previously, the purpose of this document is to serve as guiding principles for the NAIC's consideration of a principles-based approach for reserving. The principles-based reserving initiatives began within the life insurance industry and most of the work to date has been focused on those life and annuity products where such an approach is most beneficial to the regulatory process. The current draft of the NAIC's Valuation Manual does include guidance for most life, annuity and health products, but the guidance for many of the products simply represents the existing methodology in current NAIC model laws and regulations. Therefore, there is currently no proposed changes to the NAIC's reserving requirements for products such as major medical, dental, and other similar health products where the majority of the reserve represents a claim reserve. The approaches used currently to calculate such reserves are similar to those used for property and casualty lines of business, and are largely considered principle-based already, at least when compared with the approaches used for traditional life insurance products. Consequently, the need to develop new guidance in these particular types of health business is less of a concern to the regulatory process, and the need for development of such guidance will be determined by the technical groups overseeing such areas. Similarly, the need to develop any new guidance for property and casualty business will be determined by the technical groups overseeing such areas but the need for such has yet to be determined by this EX Working Group or any other NAIC group at this time. With the possible exception of governance work and some health-related products allowed to be reported on the Quarterly and Annual Statement Blank - Property/Casualty, property/casualty business is not within the scope of this current project.

Implementation

As noted within the principles, this Working Group has determined that uniformity is a requirement for the adoption of this project. However, the implementation date will be dependent upon when action can be taken by the individual states. This adds some complication to the process since the effective implementation date should be the same for all states. To address some of these complications, the NAIC has determined that the requirements of the Valuation Manual will be made effective prospectively, that is, it will only be applicable to new business. More specifically, the principles and any product (Valuation Manual) developed as a result, are not intended to replace the current framework that applies to current inforce business. This will be discussed in greater detail within the Valuation Manual.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

I. PRINCIPLES-BASED REGULATORY FRAMEWORK

A. Regulatory requirements of a principles-based framework should be transparent and objective and based on explicit principles.

Actions:

1. Establish Regulatory Principles
 - Principles-Based Reserving (EX) WG (PBRWG)-Completed December 2007
2. Define the terms “principle” and “sub-principle” and determine whether deviation from a principle or sub-principle is allowed when presented to the Working Group from an NAIC technical group.
 - PBRWG-Completed December 2007
3. Consider the need to establish Sub-principles when addressing action items.
 - Life & Health Actuarial Task Force (LHATF) & Statutory Accounting Principles (E) Working Group (SAPWG) (definition of liability & what risks should be included in liability versus capital); coordinate with Capital Adequacy (E) Task Force (CADTF), Blanks (E) Working Group & SAPWG (Disclosure), Examination Oversight (E) Task Force.

B. A principles-based regulatory framework should be created through state laws and regulations in a manner that maximizes the likelihood of uniform adoption across all states.

Actions:

1. Consider development of a model law that refers to the use of the Valuation Manual and requires uniform adoption by all of the states. Investigate the potential of having state laws refer to an NAIC Valuation Manual, rather than having detailed reserve calculations within the law itself. Consider including all guidance needed by an insurer in establishing its life, annuity and health reserves, including existing requirements where there are no proposed changes to the valuation (e.g. health). Determine what should be included in the Valuation Manual, with concentration on those aspects of a reserve valuation system that might need to be updated periodically to reflect current best practices and industry conditions. The Valuation Manual should address if the liability established reflects the prefunding inherent in the product design, and should also be established in a manner where it can be determined if the standards have been met.
 - LHATF
2. Develop a maintenance process for the NAIC Valuation Manual that meets the needs of LHATF and the SAPWG. Determine whether the Valuation Manual becomes part of the APPM or a separate manual.
 - SAPWG & LHATF
3. Propose changes to Actuarial Opinion Memorandum Regulation (AOMR) and consider incorporating into the Valuation Manual.
 - LHATF
4. Propose changes to Standard Nonforfeiture Laws necessary to implement the valuation changes.
 - LHATF
5. Review Other Model Laws and Regulations to Determine if Affected, including but not limited to the Hazardous Financial Condition Model and Model Investment Laws
 - PBRWG (might delegate)

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

6. Develop a timeline for development, adoption, and implementation of the regulatory changes required to implement this new framework.
 - PBRWG with assistance from LHATF-Completed December 2007

C. A principles-based regulatory framework should establish regulatory principles that are consistent with International Association of Insurance Supervisors (IAIS) solvency principles, where appropriate.

NOTE: For this initiative the portions of the following international solvency principles that relate to reserve liabilities (called “technical provisions”) and capital requirements will be considered:

- IAIS *Insurance Core Principles and Methodology* (October 2003)
- IAIS *Principles on Capital Adequacy and Solvency* (January 2002)
- IAIS *Standard on Disclosures Concerning Technical Risks and Performance for Life Insurers* (October 2006)
- IAIS *Supervisory Standard on On-Site Inspections* (October 1998)
- IAIS *Towards a Common Structure and Common Standards for the Assessment of Insurer Solvency: Cornerstones for the Formulation of Regulatory Financial Requirements* (October 2005)
- Consideration of other and future international principles will be out of the scope of this initiative.

Actions:

1. Material differences from international standards should be documented by the applicable technical group and reported to the PBRWG. Differences are expected in certain areas, such as health insurance, because the United States has certain health and medical markets not shared in other parts of the world. Other differences may exist because of the different legal environment, but again all differences should be documented and reported to the PBRWG.
 - LHATF, SAPWG, CADTF, Blanks, Examination Oversight

D. A principles-based regulatory framework should establish regulatory principles that address the measurement of risk inherent in the assets, liabilities and associated cash flows that are related to the insurance contracts (i.e. reserve liability and regulatory capital) of an insurance entity.

E. A principles-based regulatory framework should establish regulatory principles that address the measurement of risk inherent in the assets, liabilities and associated cash flows that are not related to the insurance contracts (i.e. regulatory capital) of an insurance entity.

F. A principles-based regulatory framework should establish regulatory principles that address governance of an insurance entity.

G. A principles-based regulatory framework should establish regulatory principles that address public disclosure, supervisory reporting, and financial analysis of an insurance entity.

H. A principles-based regulatory framework should establish regulatory principles that address the financial examination of an insurance entity.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

I. A principles-based regulatory framework, its standards, requirements, and application should weigh the potential benefits to insurance regulators and consumers against the potential costs to regulators as well as cost and burdens of compliance that will be born by each insurance company.

II. RESERVE LIABILITIES

A. The reserve liability should reflect the risks that are related to the insurance contracts.

B. The valuation methodology should reflect actuarial standards of practice and sound statutory accounting principles.

Actions:

1. Determine where to reference the need to abide by professional standards of practice.
 - LHATF
2. Establish procedure to verify that the reserves together with the assets are adequate to mature liabilities.
 - LHATF

C. The principles-based regulatory framework should allow regulators to analyze the company's reported reserves, make a different determination of the required reserves, and to take regulatory action based upon its determination of the required reserves.

- Although the financial statements are the responsibility of the management, the regulators should have the ability to require modification in the above situation. The above determination can be done either during a regularly scheduled examination, a limited scope examination or otherwise when supported by analysis of the facts and circumstances by the Commissioner. An insurer can always appeal such determination, but the insurer must establish that the reserves are adequate in such an appeal.

Actions:

1. Ensure regulatory ability to require changes to a company's booked reserves.
 - Examination Oversight
 - LHATF (Standard Valuation Law)
2. Determine whether the guidance in SSAP 55 regarding reserves being "management's best estimate" would be appropriate for life/health under principles-based reserving.
 - SAPWG
3. Determine what is "appropriate".
 - LHATF, Examination Oversight, NAIC Legal staff
4. Develop a format and scope of reviewing actuary's opinion regarding an assessment of the insurer's methods, models, assumptions and margins for principles-based reserves included in the financial statements.
 - LHATF

D. The valuation methodology used to calculate the reserve liability must measure all known quantifiable risks that are related to the insurance contract. The valuation methodology should be explicit, reliable and reflect the solvency objectives of statutory accounting and reporting.

- The valuation of reserve liabilities should be prospective.
- Reserve liabilities and future revenues should be sufficient to cover all expected future claims and associated expenses with provision for moderately adverse deviations from expected.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

Actions:

1. Define “expected claims” in regard to the benefits and guarantees net of revenues associated with the contract.
 - LHATF
2. Define which high-level risks (e.g. credit & market risk that can be replicated, operational risk, current estimate volatility, underwriting risk, etc.) are accounted for in reserve liabilities versus capital.
 - LHATF with input from CADTF
3. Establish the minimum standards for the methods and assumptions for assessing, on a reliable, verifiable, transparent and prudent basis, reserves to cover all expected claims and expenses with provision for moderately adverse deviation.
 - LHATF
4. Determine what level of aggregation is appropriate for setting the reserve liability.
 - LHATF & SAPWG
5. Determine how margins and assumptions should be established. For example, should they be established policy by policy, in aggregate for the company, etc.?
 - LHATF with input from SAPWG
6. Regulators must consider the level of prudence to require and how that must be identified by companies.
 - LHATF

E. The valuation methodology should reflect anticipated experience and include appropriate provisions for margins to address the risk of uncertainty and modeling error.

- The estimate should be based on all material and relevant future cash flows associated with the insurance portfolio.
- The margin for uncertainty would reflect the intrinsic uncertainty of insurance obligations and would reflect moderately adverse deviations over the full time horizon of the insurance contracts.

Actions:

1. The margin should reflect a provision for moderately adverse deviation in claims as well as variations in cash flows due to investment practices.
 - LHATF

F. The anticipated experience should be based upon information from the insurance entity’s experience data and business model data when relevant and credible and using financial market and insurance industry experience data when insurance entity experience data is not available or not relevant and credible.

- In some cases, homogenous industry data may not exist, such as with certain types of health insurance products.

Actions:

1. Specify those situations where the use of insurance industry experience data is not required for valuation, or required to be filed with a statistical agent, despite the lack of insurance entity experience.
 - LHATF
2. Develop a system whereby additional information regarding insurance experience is available. Define the information needed for valuation purposes. Create industry statistics for liability valuation purposes. Define a process for the reporting of data to create a collection of industry data.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

- LHATF
- 3. Describe appropriate discounting methodologies and discount rates.
 - LHATF
- 4. Determine how to identify acceptable method for credibility, while still allowing actuarial judgment.
 - LHATF

F. Regulators should have a system that provides for a quick analysis of the levels and changes in reserves. Such a system needs to be calibrated to the reserve methods employed.

Actions:

1. Estimate a high-level impact assessment of the expected change in liability values due to the use of principles-based reserving.
 - LHATF
2. Adjust financial analysis and other formulaic regulatory calculations to re-calibrate based upon the new levels of reserve liabilities and to use the new actual to expected reporting.
 - Financial Analysis Research and Development WG
 - Financial Analysis Handbook WG
 - Financial Examiners Handbook Technical Group

III. CAPITAL ADEQUACY

A. Regulatory capital should be required to provide a solvency margin to reflect the risk of potential adverse deviation in the anticipated experience assumptions used in the measurement of the risks reflected in the reserve liability. Regulatory capital should also be required to provide a solvency margin that reflects risks that are not related to the insurance contracts and therefore not reflected in the reserve liability.

Actions:

1. Determine whether to require that insurers undertake regular stress testing for a range of adverse scenarios in order to assess the adequacy of capital resources, and further specify which types of business are excluded from this requirement (e.g. health). If stress testing is to be required, determine when, what and how to test.
 - CADTF
2. Determine a standard for risk in terms of a confidence interval and time horizon that establishes a minimum capital standard for regulatory purposes.
 - CADTF
3. Define a process and timeframe to apply risk management techniques to the determination of other risks, including default and pricing risks.
 - CADTF

B. A regulatory capital framework should include a range of solvency control levels which trigger different degrees of regulatory intervention and regulatory action. The valuation methodology used to calculate regulatory capital should be consistent, where appropriate, with the valuation methodology used to calculate reserves and should reflect actuarial standards of practice and statutory accounting principles.

Actions:

1. Describe “all relevant and material risks”.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

- CADTF, in consultation with the identification of risks to be included in reserve liabilities.
 - Note: Inclusion of additional risks that are not currently evaluated within RBC should be handled as a separate project from the principles-based reserving initiative unless it is identified that the risk was previously covered in liability valuation and thus capital needs to be re-calibrated to cover such risk.
2. IAIS proposed standards should be reviewed and all deviations in the NAIC proposals should be identified and explained.

C. Risk-based capital should include a range of solvency control levels and the regulatory instruments associated with each of the control levels. There should be a number of solvency control levels which trigger different degrees of intervention by the regulator, in a timely manner. The regulator should have due regard to the coherence of the solvency control levels and any corrective action that may be at the disposal of the insurer, and of the regulator, including options to reduce the risks being taken by the insurer as well as to raise more capital.

Actions:

1. Review the use of multipliers in the action levels or study whether to modify the formula if the capital levels for the action levels would no longer be appropriate.
- CADTF

D. A set of standardized and more advanced approaches to determine the solvency requirements should be allowed, but not necessarily required. Such approaches could include the use of internal models, company specific assumptions and approaches, or other appropriate means to determine minimum solvency requirements

Actions:

1. This principle will be handled outside of the work of the principles-based reserving activities. The regulatory review process should be evaluated.
- CADTF

E. The total amount of reserve liability plus regulatory capital should be able to absorb significant unforeseen losses.

- Reserves and capital should be based upon the same risk measures and model.
- The risk measures and model used should specify how unforeseen losses are determined.

Actions:

1. Re-calibrate the capital requirements based on the over-all levels of reserve liabilities.
- CADTF, in consultation with LHATF
2. Look at probability and duration.
- CADTF

IV. CORPORATE GOVERNANCE:

A. The principles-based regulatory framework should require that the board of directors and senior management actively develop, maintain and implement corporate governance policies and practices for principle-based reserving of products subject to any such new methodologies.

- The requirements should consider the need to allow flexibility for how the policy and practice is carried out by the company. The requirements will consist primarily of those necessary for an effective process related to principles-based reserves and capital.

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

- The requirements should consider the need to define the roles, requirements and responsibilities of accountants, auditors and actuaries and ensure that there are adequate personnel to fill those roles and ensure that such personnel are competent and experienced.
- The requirements should consider the need to provide the Appointed Actuary direct access to the board or committee responsible for these policies and practices.

Actions:

1. Identify appropriate practices; use the AAA document and other standards as input.
 - PBRWG Corporate Governance Subgroup; input from LHATF, NAIC/AICPA WG
2. Review the specific roles, requirements, and qualifications for appointed actuaries contained within the Standard Valuation Law and AOMR and recommend any changes necessary, including making sure the appointed actuaries have direct access to the board.
 - LHATF
3. Determine any modifications to the reserve certification process and, if desired, establish an independent review process.
 - LHATF

B. The principle-based regulatory framework should require sound risk management practices, including the consideration of new oversight requirements for the boards of directors and senior management.

- The requirements under this principle are broad, and would include corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility.

Actions:

1. Identify appropriate practices; use the draft IAIS risk management standard as input.
 - PBRWG Corporate Governance Subgroup; input from LHATF, CADTF, NAIC/AICPA WG, International Solvency & Accounting (E) Working Group

V. PUBLIC DISCLOSURE, SUPERVISORY REPORTING, FINANCIAL ANALYSIS:

A. The principles-based regulatory framework should require regular filing of pertinent financial information that allows analysis of the information related to principles-based reserves. The principles-based regulatory framework should specify which financial information should be made public and which financial information should be kept confidential.

- Focus report on the areas of greatest risk and regulatory concern.

Actions:

1. Modify the quarterly and annual statement blanks to allow for proper monitoring and disclosure regarding principles-based reserves. There should be sufficient information to effectively monitor areas of financial risk, as well as provide disclosure to the public, which could include a combination of types of information (quantitative and qualitative). The decision on the type of qualitative information should consider the value of narrative information that explains things in simple terms.
 - SAPWG, LHATF, Financial Analysis Handbook WG, Financial Examiners Handbook Technical Group, CADTF with Blanks in charge
2. Require both current and prospective information. Create reporting requirements that can be used to evaluate actual development of claims to those previously-reported expected.
 - SAPWG, LHATF, Financial Analysis Handbook WG, Financial Examiners Handbook Technical Group, CADTF with Blanks in charge

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

3. Establish public disclosure and supervisory reporting requirements. Consider the level of detail needed to avoid public disclosure of proprietary information. Strike a balance between the need for information for supervisory purposes and the administrative burden it puts on insurers. The decision on the appropriate supervisory reporting should consider the value of narrative information that explains the company's process in simple terms.
 - SAPWG, LHATF, Financial Analysis Handbook WG, Financial Examiners Handbook Technical Group, CADTF with Blanks in charge of public disclosure requirements.
 - LHATF in charge of supervisory reporting requirements.
4. Determine the appropriate reporting for the current estimate and the margin for uncertainty (reported separately or combined on the balance sheet). Consider the advantages of obtaining such information in light of the possible subjectively required to develop the margin for uncertainty figure.
 - SAPWG, Blanks WG, LHATF

B. The principles-based regulatory framework should allow the regulator the authority to request and obtain any additional information necessary to determine compliance with laws and regulations.

- The principles-based regulatory framework should provide that the regulator can receive necessary information to conduct effective off site (e.g. financial analysis) monitoring and evaluation of the condition of each insurer as well as the insurance market.

Actions:

1. Make sure this information can be required.
 - LHATF (Reporting & Documentation Requirements)
 - Financial Analysis Handbook WG
 - Financial Examiners Handbook Technical Group

C. The principles-based regulatory framework should require that all actuarial reports that document the work product and processes that were completed in the determination of the reserve liability and required regulatory capital should be filed. The principles-based regulatory framework should require an actuarial opinion from the Appointed Actuary whether the reserve liability and required capital complies with all laws and regulations. The principles-based regulatory framework should provide for a confidential central filing data base to collect all financial information, experience data, opinions, certifications and corporate governance policies and practices that are required to be filed.

Actions:

1. Determine which type of reports, what information should be disclosed in those reports, and the timing of the reports. At a minimum, companies should be required to obtain an annual actuarial evaluation to demonstrate the appropriateness of the level of reserves.
 - LHATF, Examination Oversight
2. Require insurers to demonstrate and document the reliability of their valuation assumptions and substantiate their use of data, whether company-specific or of a more general nature.
 - LHATF (& Actuarial Standards of Practice)

LIFE AND HEALTH INSURANCE PRINCIPLES & RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES

VI. FINANCIAL EXAMINATIONS

A. The principles-based regulatory framework should require periodic financial examinations of insurance entities including analysis and review of all financial information filed in the central data base as well as on-site inspections to determine if the insurance entity is in compliance with all laws and regulations.

- Examination of the reserve liability and regulatory capital should focus on the adequacy of the valuation methodology and the accuracy and completeness of data used in the process.
- Examination requirements should be consistent, uniform and utilize regulatory resources effectively.
- Examination priority, frequency, scope and detail should be risk sensitive taking into account the overall level of risk and the solvency control level of the insurance entity.
- In conducting examinations, regulators should establish procedures that minimize the redundancy of efforts by both regulators and companies.
- Examination results and regulatory actions taken based on examination should provide a regulatory feedback loop to improve overall examination and regulation

Actions:

1. Determine what adjustments need to be made to the financial examination process in regard to the establishment of reserve liabilities, especially as they relate to management and internal control systems, compliance with corporate governance as required in the reserve framework, the frequency and depth of examinations, and any impacts from adjustments in the reserve liability values.

- Financial Examiners Handbook Technical Group, with input from CADTF, LHATF, and PBRWG Corporate Governance Subgroup

2. Establish the processes for regulatory assessment of the methods and assumptions used to establish reserves, the sufficiency of those reserves, and risk-based capital. The process should consider if an opinion on the insurer's methods, models, assumptions and models has already been issued, as well as the extent to which procedures have already been performed by the CPA firm and can be tested and relied upon, and thus minimize the potential duplication of duties performed by the reviewing actuary, the examiner and the CPA firm.

- Financial Examiners Handbook Technical Group, with input from CADTF, LHATF

3. Investigate a central process to compare reviews or review processes utilized by the various states in conducting their examination of the insurer's methods, models, assumptions and models. The intent of such a central process is to bring uniformity to the manner in which these reviews are conducted. The details of the tasks to be performed by this central process should be determined and documented but should also include the consideration of developing a modeling tool that would enable reasonableness of a companies models.

- LHATF

B. Regulators should assess the effectiveness of controls surrounding the data and calculations used to determine the financial statement, including reserve valuation and minimum required capital calculations. Such assessment should reflect the materiality and relevance of information.

Actions:

1. Determine if any additional controls are needed.

- Financial Examiners Handbook Technical Group with input from LHATF

2. Determine the frequency and scope of any new requirements, especially as they relate to any new reports.

**LIFE AND HEALTH INSURANCE
PRINCIPLES
& RELATED PRINCIPLES-BASED INITIATIVE ACTIVITIES**

- Financial Examiners Handbook Technical Group and NAIC/AICPA WG, with input from LHATF and CADTF & F Committee