**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.

Staff of Office of Principle-Based Reserving, California Department of Insurance,   
 Stress the meaning of “materiality”

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 (January 1, 2018 edition), with NAIC Adoptions through August 8, 2017,   
Introduction, VM-20 and VM-31

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 Appendix.

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

See attached Appendix.

NAIC Staff Comments:

|  |  |  |  |
| --- | --- | --- | --- |
| **Dates:** Received | Reviewed by Staff | Distributed | Considered |
|  |  |  |  |
| **Notes:** **VM APF 2018-39 (CA APF BR)** | | | |

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#### Appendix

#### ISSUE:

A material change in the PBR reserve may not seem material in the context of a company’s overall life reserves. It could be helpful to make the intent of the *Valuation Manual* as to this point more clear in a few places.

#### SECTIONS:

Introduction, VM-20, VM-31

#### REDLINE:

**Section II, Overview of Reserve Concepts**

A principle-based valuation must only reflect risks that are:

1. Associated with the policies or contracts being valued, or their supporting assets.

1. Determined to be capable of affecting the size of the modeled reserve by a material percentage thereof.

**VM-20 Section 2.G**

G. A company may use simplifications, approximations and modeling efficiency techniques to calculate the DR and/or SRrequired by this section if the company can demonstrate that the use of such techniques does not understate such reserve by a material percentage thereof, and the expected value of the reserve calculated using simplifications, approximations and modeling efficiency techniques is not less than the expected value of the reserve calculated that does not use them. The preceding demonstration requirements of Section 2.G do not apply to the use of model segmentation for purposes of determining the net asset earned rates.

**VM-20 Section 8.C.13**

13. The company shall set assumptions in a manner consistent with Section 8.C.10, taking into account an assuming company’s right to terminate in-force reinsurance business. In the case in which the assuming company’s right to terminate is limited to cases of non- payment of amounts due by the ceding company or other specific, limited circumstances, the company may assume that the termination option would be expected to have insignificant value to either party and, therefore, may exclude recognition of this right to terminate in the cash-flow projections. However, if a reinsurance agreement contains other termination provisions that impact the modeled reserve by a material percentage, the company shall set appropriate assumptions for these provisions consistent with the particular scenario being tested.

**VM-20 Section 9.A.7**

7. The company shall examine the results of sensitivity testing to understand the materiality of prudent estimate assumptions on the modeled reserve. The company shall update the sensitivity tests periodically as appropriate, considering the materiality (judged in terms of percentage impact on the size of the modeled reserve) of the results of the tests. The company may update the tests less frequently when the tests show less sensitivity of the modeled reserve to changes in the assumptions being tested or the experience is not changing rapidly. Providing there is no material impact on the results of the sensitivity testing, the company may perform sensitivity testing:

* 1. Using samples of the policies in force rather than performing the entire valuation for each alternative assumption set.
  2. Using data from prior periods.

**VM-20 Section 9.B.4**

4. A margin is not required for assumptions when variations in the assumptions do not impact the size of the modeled reserve by a material percentage thereof.

**VM-20 Section 9.D.1.a**

a. Reflect expectations regarding variations in anticipated policyholder behavior relative to characteristics that impact the modeled reserve by a material percentage thereof. These may include gender, attained age, issue age, policy duration, time to maturity, tax status, level of account and cash surrender value, surrender charges, transaction fees or other policy charges, distribution channel, product features, and whether the policyholder and insured are the same person.

**VM-31 Section 3.D.11.g (will become 3.C.11.h under 2017-94)**

g. Use of Date Preceding Valuation Date – If the company uses a date that precedes the valuation date to calculate the reserves, the company shall explain why the use of such date will not produce a change in the results of the principle-based valuation by a material percentage thereof if the results were based on the valuation date. Such explanation shall describe the process the qualified actuary used to determine the adjustment, the amount of the adjustment and the rationale for why the adjustments are appropriate.

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#### REASONING:

Help ensure that the small size of the PBR reserve in the early years is not used as justification for roughshod PBR methodology.