## VM-01: Definitions for Terms in Requirements

This VM-01 provides definitions for terms used in the Valuation Manual. The definitions in this VM-01 do not apply to documents outside the Valuation Manual even if referenced or used by the Valuation Manual such as the NAIC Accounting Practices and Procedures Manual. Some terms in the Valuation Manual may be defined in specific sections of the Valuation Manual instead of being defined in this VM-01.

**Guidance Note:** Any terms defined in Model #820 are noted.

* The term “accident and health insurance” means contracts that incorporate morbidity risk and provide protection against economic loss resulting from accident, sickness or medical conditions and as may be specified in the *Valuation Manual*. (Model #820 definition.)
* The term “accumulated deficiency” means an amount measured as of the end of a projection year and equals the negative of the projected statement value of general account and separate account assets, as of the end of the projection year. Accumulated deficiencies may be positive or negative. A positive accumulated deficiency means that there is a cumulative asset shortfall. (Used in VM-20 and VM-21.)
* The term “Actuarial Standards Board” means the board established by the American Academy of Actuaries (Academy) to develop and promulgate actuarial standards of practice (ASOPs).
* The term “annual statement” means the statutory financial statements a company must file using the annual blank with a state insurance commissioner as required under state insurance law.
* The term “anticipated experience assumption” means an expectation of future experience for a risk factor given available, relevant information pertaining to the assumption being estimated.

**Guidance Note:**

A universally accepted definition of relevant information is not to be found in actuarial literature, but certainly relevant experience is a part of what constitutes relevant information. Actuarial judgment is required in selecting and applying relevant information. In the case of relevant experience, the actuary is given guidance in ASOP 52 and ASOP 25 defining relevant experience and discussing the selection of relevant experience.

* An appointed actuary is a qualified actuary who:
* Is appointed by the board of directors, or its equivalent, or by a committee of the board, by Dec. 31 of the calendar year for which the opinion is rendered.
* Is a member of the American Academy of Actuaries.
* Is familiar with the valuation requirements applicable to life and health insurance.
* Has not been found by the commissioner (or if so found has subsequently been reinstated as a qualified actuary), following appropriate notice and hearing to have:
* Violated any provision of, or any obligation imposed by, the insurance law or other law in the course of his or her dealings as a qualified actuary.
* Been found guilty of fraudulent or dishonest practices.
* Demonstrated incompetency, lack of cooperation or untrustworthiness to act as a qualified actuary.
* Submitted to the commissioner during the past five years, pursuant to these AOM requirements, an actuarial opinion or memorandum that the commissioner rejected because it did not meet the provisions of this regulation including standards set by the Actuarial Standards Board.
* Resigned or been removed as an actuary within the past five years as a result of acts or omissions indicated in any adverse report on examination or as a result of failure to adhere to generally acceptable actuarial standards.
* Has not failed to notify the commissioner of any action taken by any commissioner of any other state similar to that under the paragraph above.
* The term “asset adequacy analysis” means an analysis of the adequacy of reserves and other liabilities being tested, in light of the assets supporting such reserves and other liabilities, as specified in the actuarial opinion.
* The term “asset-associated derivative” means a derivative program whose derivative instrument cash flows are combined with asset cash flows in performing the reserve calculations.
* The term “cash flows” means any receipt, disbursement, or transfer of cash or asset equivalents.
* The term “cash-flow model” means a model designed to simulate asset and liability cash flows.
* The term “cash surrender value” means, for purposes of these requirements, the amount available to the contract holder upon surrender of the contract, prior to any outstanding contract indebtedness and net of any applicable surrender charges and stated in the contract. The surrender charge reflects the availability of any free partial surrender options. For contracts where all or a portion of the amount available to the contract holder upon surrender is subject to a market value adjustment, however, the cash surrender value shall reflect the market value adjustment consistent with the required treatment of the underlying assets. That is, the cash surrender value shall reflect any market value adjustments where the underlying assets are reported at market value, but shall not reflect any market value adjustments where the underlying assets are reported at book value.
* The term “clearly defined hedging strategy” (CDHS) means a strategy undertaken by a company to manage risks through the future purchase or sale of hedging instruments and the opening and closing of hedging positions. In order to qualify as a clearly defined hedging strategy, the strategy must meet the principles outlined in the VM-21 Section 1.B (particularly Principle 5) and shall, at a minimum, identify:

i. The specific risks being hedged (e.g., delta, rho, vega, etc.).

ii. The hedge objectives.

iii. The risks not being hedged (e.g., variation from expected mortality, withdrawal, and other utilization or decrement rates assumed in the hedging strategy, etc.).

iv. The financial instruments that will be used to hedge the risks.

v. The hedge trading rules, including the permitted tolerances from hedging objectives.

vi. The metric(s) for measuring hedging effectiveness.

vii. The criteria that will be used to measure hedging effectiveness.

viii. The frequency of measuring hedging effectiveness.

ix. The conditions under which hedging will not take place.

x. The person or persons responsible for implementing the hedging strategy.

xi.         Areas where basis, gap or assumption risk related to the hedging strategy have been identified.

xii.          The circumstances under which hedging strategy will not be effective in hedging the risks.

It is important to note that strategies involving the offsetting of the risks associated with contract guarantees with other products that are subject to the reserve ~~scope of different~~ requirements of a different VM section ~~outside of the scope of these requirements~~ (e.g., equity-indexed annuities subject to sections of VM-22 vs. variable annuity guarantee subject to sections of VM-21) do not ~~currently~~ qualify as clearly defined hedging strategies under these requirements.

* The term “commissioner” means the chief insurance regulator of a state, district or territory of the U.S.
* The term “company” means an entity that (a) has written, issued or reinsured life insurance contracts, accident and health insurance contracts, or deposit-type contracts in this state and has at least one such policy in force or on claim; or (b) has written, issued or reinsured life insurance contracts, accident and health insurance contracts, or deposit-type contracts in any state and is required to hold a certificate of authority to write life insurance, accident and health insurance or deposit-type contracts in this state. (Model #820 definition.)
* The term “conditional tail expectation” (CTE) means a risk measure that is calculated as the average of all modeled outcomes (ranked from lowest to highest) above a prescribed percentile. For example, CTE 70 is the average of the highest 30% modeled outcomes.
* The term “contract reserve” means a liability established for health and credit insurance with respect to inforce contracts equal to the excess of the present value of claims expected to be incurred after a valuation date over the present value of future valuation net premiums.
* The term “deposit-type contract” means contracts that do not incorporate mortality or morbidity risks and as may be specified in the *Valuation Manual*. (Model #820 definition.)
* The term “derivative instrument” means an agreement, option, instrument or a series or combination thereof:
  + - To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof.
* That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests. (Source: AP&P Manual.)

This includes, but is not limited to, an option, warrant, cap, floor, collar, swap, forward or future, or any other agreement or instrument substantially similar thereto or any series or combination thereof. Each derivative instrument shall be viewed as part of a specific derivative program.

* The term “derivative program” means a program to buy or sell one or more derivative instruments or open or close hedging positions to achieve a specific objective. Both hedging and non-hedging programs (e.g., for replication or income generation objectives) are included in this definition.
* The term “deterministic reserve” means a reserve amount calculated under a single defined scenario, using a combination of prescribed and company-specific assumptions derived as provided in the *Valuation Manual*.
* The term “discount rates” means the path of rates used to derive the present value.
* The term “domiciliary commissioner” means the chief insurance regulatory official of the state of domicile of the company.
* The term “elimination period” means a specified number of days, weeks or months startng at the beginning of each period of loss, during which no benefits are payable.
* The term “fraternal benefits” means payments made for charitable purposes by a fraternal life insurance company that are consistent with and/or support the fraternal purposes of the company.
* The term “gross wealth ratio” means the cumulative return for the indicated time period and percentile (e.g., 1.0 indicates that the index is at its original level).
* The term “Guaranteed Issue life insurance policy” means a life insurance policy or certificate where the applicant must be accepted for coverage if the applicant is eligible. Additionally, the following must hold:
  + Eligibility requirements may include being within a specified age range and/or being an active member in an eligible group (e. g. group solicitation in direct marketing)
  + Inclusion of any of the following characteristics or product types disqualifies the policy as GI:
  + Actively at work requirement
  + Employer groups
  + Acceptance based on any health-related questions or information
  + Waiving of underwriting requirements based on minimum participation thresholds, such as for worksite marketing
  + Corporate Owned Life Insurance or Bank Owned Life Insurance
  + Credit life contracts
  + Juvenile-only products (e. g. under age 15)
  + Preneed life contracts
  + Policies and certificates issued as a result of exercising a provision (e.g., conversion or Guaranteed Insurability Option riders) from a policy, rider or certificate that do not qualify as Guaranteed Issue life insurance.
* The term “guaranteed minimum death benefit” (GMDB) guarantees, or results in a provision that guarantees, that the amount payable on the death of a contract holder, annuitant, participant or insured:
  + will be not less than, or
  + will be increased by, a minimum amount which may be either specified by or computed from other policy or contract values; and
    - has the potential to produce a contractual total amount payable on such death that exceeds the account value, or
    - in the case of an annuity providing income payments, guarantees payment upon such death of an amount payable on death in addition to the continuation of any guaranteed income payments.

Guidance Note: The definition of GMDB includes benefits that are based on a portion of the excess of the account value over the net of premiums paid less partial withdrawals made (e.g., an earnings enhanced death benefit).

* The term “Guaranteed Minimum Accumulation Benefit (GMAB)” means a guaranteed benefit providing, or resulting in the provision, that an amount payable on the contractually determined maturity date of the benefit will be increased and/or will be at least a minimum amount. Only such guarantees having the potential to produce a contractual total amount payable on benefit maturity that exceeds the account value, or in the case of an annuity providing income payments, an amount payable on benefit maturity other than continuation of any guaranteed income payments, are included in this definition.
* The term “guaranteed minimum income benefit” (GMIB) means an option under which the contract holder has the right to apply a specified minimum amount that could be greater than the amount that would otherwise to available in the absence of such benefit to provide periodic income using a specified purchase basis.
  1. The term “Hybrid GMIB” means a GMIB design that (i) provides guaranteed growth in the benefit basis (i.e., benefit growth that does not depend on the performance of the Account Value), and (ii) adjusts the benefit for partial withdrawals by the same dollar amount as the partial withdrawal amount for partial withdrawal amounts not in excess of a stated maximum amount.
  2. The term “Traditional GMIB” means a GMIB design that is not a hybrid GMIB.
* The term “Guaranteed Minimum Withdrawal Benefit (GMWB)” means a design providing, or resulting in the provision, that the amount withdrawable by the contract holder each year will at least be a minimum amount until the benefit amount depletes or until a contractually specified event occurs, provided that the contract holder does not exceed a maximum withdrawal amount.
  1. The term “Lifetime GMWB” means a GMWB design providing, or resulting in the provision, that the amount withdrawable by the contract holder each year will at least be a minimum amount until the contract holder’s death provided that the contract holder does not exceed a maximum withdrawal amount.
  2. The term “Non-lifetime GMWB” means a GMWB design providing, or resulting in the provision, that the amount withdrawable by the contract holder each year will at least be a minimum amount until and only until the benefit amount depletes, even if such depletion occurs before the contract holder’s death, provided that the contract holder does not exceed a maximum withdrawal amount.
* The term “guaranteed payout annuity floor” (GPAF) means a provision in an immediate annuity contract that guarantees that one or more of a series of periodic payments under the annuity will not be less than a specified minimum amount that could be greater than the amount that would otherwise to available in the absence of such benefit.
* The term “industry basic table” means an NAIC-approved industry experience mortality table (without the valuation margins).
* The term “life insurance” means contracts that incorporate mortality risk, including annuity and pure endowment contracts, and as may be specified in the *Valuation Manual*. (Model #820 definition.)
* The term “margin” means an amount included in the assumptions, except when the assumptions are prescribed, used to determine the modeled reserve that incorporates conservatism in the calculated value consistent with the requirements of the various sections of the *Valuation Manual*. It is intended to provide for estimation error and adverse deviation.
* The term “modeled reserve” means the deterministic reserve on the policies determined under VM-20 Section 2.A.1.a, 2.A.2.a, 2.A.3.b plus the greater of the deterministic reserve and the stochastic reserve on the policies determined under Section 2.A.1.b, 2.A.2.b and 2.A.3.c.
* The term “model segment” means a group of policies and associated assets that are modeled together to determine the path of net asset earned rates.
* The term “mortality segment” means a subset of policies for which a separate mortality table representing the prudent estimate assumption will be determined.
* The term “NAIC” means the National Association of Insurance Commissioners. (Model #820 definition.
* The term “net asset earned rates” (NAER) means the path of earned rates reflecting the net general account portfolio rate in each projection interval (net of appropriate default costs and investment expenses).
* The term “net premium reserve” (NPR) means the amount determined in Section 3 of VM-20.
* The term “non-guaranteed elements” (NGE) means either: (a) dividends under participating policies or contracts; or (b) other elements affecting life insurance or annuity policyholder/contract-holder costs or values that are both established and subject to change at the discretion of the insurer.
* The term “non-material secondary guarantee” means a secondary guarantee (SG) that meets the following parameters at time of issue:
  + The policy has only one SG and that SG is in the form of a required premium (specified annual or cumulative premium).
  + The duration of the SG for each policy is no longer than 20 years from issue through issue age 60, grading down by 2/3-year for each higher issue age to age 82, thereafter five years.
  + The present value of the required premium under the SG must be at least as great as the present value of net premiums resulting from the appropriate unloaded CSO table over the maximum SG duration allowable under the contract (in aggregate and subject to above duration limit).
* Present values use minimum allowable unloaded CSO table rates (preferred tables are subject to existing qualification requirements) and the maximum valuation interest rate as defined in VM-20 Section 3.C.2.
* The minimum premium consists of the annual required premium over the maximum SG duration.

**Guidance Note:** The unloaded version of the applicable CSO table is available on the Society of Actuaries (SOA) website.

* The term “path” means a time-indexed sequence of a set of values.
* The term “Principle-Based Reserve Actuarial Report” (PBR Actuarial Report) means the supporting information prepared by the company as required by VM-31.
* The term “policyholder behavior” means any action a policyholder, contract holder or any other person with the right to elect options, such as a certificate holder, may take under a policy or contract subject to Model #820 including, but not limited to, lapse, withdrawal, transfer, deposit, premium payment, loan, annuitization, or benefit elections prescribed by the policy or contract but excluding events of mortality or morbidity that result in benefits prescribed in their essential aspects by the terms of the policy or contract. (Model #820 definition.)
* The term “policyholder efficiency” means the phenomenon that policyholders will act in their best interest with regard to the value of their policy. A policyholder acting with high policyholder efficiency would take actions permitted in their contract which would provide the greatest relative value. Such actions include but are not limited to not lapsing a low value or no value contract, persisting, surrendering, applying additional premium, and exercising loan and partial surrender provisions.
* The term “pretax interest maintenance reserve” (PIMR) means the statutory interest maintenance reserve liability adjusted to a pretax basis for each model segment at the projection start date.
* The term “principle-based valuation” means a reserve valuation that uses one or more methods or one or more assumptions determined by the insurer and is required to comply with Section 12 of the Model #820 as specified in the *Valuation Manual*. (Model#820 definition.) The term “projection interval” means the time interval used in the cash-flow model to project the cash-flow amounts (e.g., monthly, quarterly, annually).
* The term “projection period” means the period over which the cash-flow model is run. (This definition applies to life and annuity products only.)
* The term “projection start date” means the date on which the projection period begins.
* The term “projection year” means a 12-month period starting on the projection start date or an anniversary of the projection start date.
* The term “prudent estimate assumption” means a risk factor assumption developed by applying a margin to the anticipated experience assumption for that risk factor.
* The term “qualified actuary” means an individual who is qualified to sign the applicable statement of actuarial opinion in accordance with the Academy qualification standards for actuaries signing such statements and who meets the requirements specified in the *Valuation Manual*. (Model #820 definition.)
* The term “reinsurance cash flows” means the amount paid under a reinsurance agreement between a ceding company and an assuming company. Positive reinsurance cash flows shall represent amounts payable from the assuming company to the ceding company; negative reinsurance cash flows shall represent amounts payable from the ceding company to the assuming company.
* The term “revenue sharing” means any arrangement or understanding by which an entity responsible for providing investment or other types of services makes payments to the company or to one of its affiliates. Such payments are typically in exchange for administrative services provided by the company or its affiliate, such as marketing, distribution and recordkeeping. Only payments that are attributable to charges or fees from the underlying variable funds or mutual funds supporting the policies or contracts that fall under the scope of the given standard shall be included in the definition of “revenue sharing.”
* The term “risk factor” means an aspect of future experience that is not fully predictable on the valuation date.
* The term “scenario” means a projected sequence of events or risk factors used in the cash-flow model, such as future interest rates, equity performance or mortality.
* The term “scenario greatest present value” means the sum, for a given scenario, of:
* The greatest of the present values, as of the projection start date, of the projected accumulated deficiencies for the scenario.
* The starting asset amount.
* The term “scenario reserve” means the amount determined on an aggregated basis for a given scenario that is used as a step in the calculation of the stochastic reserve.
* The term “secondary guarantee” means a conditional guarantee that a policy will remain in force, even if its fund value is exhausted, for either:
  + - More than five years (the secondary guarantee period), or
    - Five years or less (the secondary guarantee period) if the specified premium for the secondary guarantee period is less than the net level reserve premium for the secondary guarantee period based on the CSO valuation tables defined in VM-20 Section 3.C and VM-M and the valuation interest rates defined in this Section, or if the initial surrender charge is less than 100% of the first year annualized specified premium for the secondary guarantee period.
* The term “starting asset amount” means an amount equal to the statement value of assets at the cash flow projection start date.
* The term “stochastic exclusion test” means a test to determine whether a group of policies is required to comply with stochastic modeling requirements.
* The term “stochastic reserve” means the reserve amount determined by applying a measure (e.g., a prescribed CTE level) to the distribution of scenario reserves over a broad range of stochastically generated scenarios and using a combination of prescribed and company-specific assumptions derived as provided in the *Valuation Manual.* The term “tail risk” means a risk that occurs either where the frequency of low probability events is higher than expected under a normal probability distribution or where there are observed events of very significant size or magnitude. (Model #820 definition.)
* The term “unearned premium reserve” means that portion of the premium paid or due to the company that is applicable to the period of coverage extending beyond the valuation date.
* The term “universal life insurance policy” means a life insurance policy where separately identified interest credits (other than in connection with dividend accumulations, premium deposit funds or other supplementary accounts) and mortality and expense charges are made to the policy. A universal life insurance policy may provide for other credits and charges, such as charges for cost of benefits provided by rider.
* The term “valuation date” means the date when the reserve is to be valued as required by the Model #820.
* The term “*Valuation Manual*” means the manual of valuation instructions adopted by the NAIC as specified in Model #820 or as subsequently amended. (Model #820 definition.)
* The term “variable annuity guaranteed living benefit” (VAGLB) means a guaranteed benefit providing, or resulting in the provision that, one or more guaranteed benefit amounts payable or accruing to a living contract holder or living annuitant, under contractually specified conditions (e.g., at the end of a specified waiting period, upon annuitization or upon withdrawal of premium over a period of time), will increase contractual benefits should the contract value referenced by the guarantee (e.g., account value) fall below a given level or fail to achieve certain performance levels. Only such guarantees having the potential to provide benefits with a present value as of the benefit commencement date that exceeds the contract value referenced by the guarantee are included in this definition. Payout annuities without minimum payout or performance guarantees are neither considered to contain nor to be VAGLBs.
* The term “variable life insurance policy” means a policy that provides for life insurance the amount or duration of which varies according to the investment experience of any separate account or accounts established and maintained by the insurer as to the policy.
* ~~The term “working reserve” means the assumed estimated reserve amount used in the projections of Accumulated Deficiencies supporting the calculation of the scenario greatest present values.~~

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