



# Valuation Manual

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## VM-G: Appendix G – Corporate Governance Guidance for Principle-Based Reserves

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### Section 1: Introduction, Definition and Scope

- A. A principle-based approach to the calculation of reserves places the responsibility for actuarial and financial assumptions with respect to the determination of sufficient reserves on individual companies, as compared with reserves determined strictly according to formulas prescribed by regulators. This responsibility requires that sufficient measures are established for oversight of the function related to principle-based reserves.

The corporate governance guidance provided in VM-G is applicable only to a principle-based valuation calculated according to methods defined in VM-20 and VM-21, except for the following condition:

For a company that does not compute any deterministic or SR under VM-20 as a result of passing the exclusion tests as defined in VM-20 Section 6, and all contracts subject to reserves under VM-21 are determined by application of the Alternative Methodology, VM-G Sections 2 and 3 below are generally not applicable; the requirements of Section 4 are still applicable. However, if the company calculated the SERT using the DR method outlined in VM-20 Section 6.A.2.b.i.a, or the Stochastic Exclusion Demonstration Test outlined in VM-20 Section 6.A.3, then VM-G Sections 2 and 3 are applicable.

**Guidance Note:** Given requirements in AG 43 are intended to be the same as those in VM-21, if a company chooses to aggregate business subject to AG 43 with business subject to VM-21 in calculating the reserve, then the provisions in VM-G apply to this aggregate principle-based valuation.

- B. In carrying out the responsibility described in Section 1.A for each group of policies and contracts subject to Section 12 of Model #820, the company shall assign to one or more qualified actuaries the responsibilities indicated in Section 4.A.
- C. For the purposes of VM-G:
1. The term “group of insurance companies” means a set of insurance companies in a holding company system (for purposes of applicable insurance holding company system acts) that is designated as a group of insurance companies by the senior management of any holding company that is a holding company of all the insurance companies in such set of insurance companies.
  2. The terms “board” and “board of directors” mean: (a) the board of an insurance company that has not been designated to be part of a group of insurance companies; or (b) the board of a single company within a group of insurance companies that is designated by the senior management of any holding company of all the insurance companies in such group of insurance companies, or a committee of such board, consisting of members of such board, duly appointed by such board and authorized by such board to perform functions substantially similar to those described in this section.

**Guidance Note:** The group of companies is a group of life insurers designated by senior management for purposes of managing the PBR process, and the board is the appropriate board responsible for those companies.

3. The term “senior management” includes the highest ranking officers of an insurance company or group of insurance companies with responsibilities for operating results, risk assessment and financial reporting (e.g., the chief executive officer [CEO], chief financial officer [CFO], chief actuary and chief risk officer [CRO]) and such other senior officers as may be designated by the insurance company or group of insurance companies.

- D. Section 2 and Section 3 below, while not expanding the existing legal duties of a company’s board of directors and senior management, provide guidance that focuses on their roles in the context of principle-based valuations. Section 2 and Section 3 are not applicable for companies meeting the requirements to be exempt from Section 2 and Section 3 as outlined in Section 1.A above.

While existing governance standards encompass adequate and appropriate standards for oversight of PBR, Section 2 and Section 3 below describe guidance for the roles of the board of directors and senior management, in light of their existing duties as applied in the context of PBR. It is not intended to create new duties but rather to emphasize and clarify how their duties apply to the PBR actuarial valuation function of an insurance company or group of insurance companies. To the extent that any law or regulation conflicts with the guidance described herein, such other law or regulation shall prevail, and the conflicting parts of this section VM-G shall not apply.

- E. The company shall retain governance documentation on file for at least seven years from the valuation date, including that required by VM-G Section 2.A.5, Section 3.A.6 and Section 4.A.3. This documentation shall be available upon request.

## Section 2: Guidance for the Board

- A. Commensurate with the materiality of PBR in relationship to the overall risks borne by the insurance company and consistent with its oversight role, the board is responsible for:
  1. Overseeing the process undertaken by senior management to identify, and correct where needed, any material weakness in the internal controls of the insurance company or group of insurance companies with respect to a principle-based valuation.
  2. Overseeing the infrastructure (consisting of policies, procedures, controls and resources) in place to implement principle-based valuation processes.
  3. Receiving and reviewing the reports and certifications referenced in Section 3.A.6.
  4. Interacting with senior management to resolve questions and collect additional information as the board requests.
  5. Documenting the review and actions undertaken by the board, relating to the principle-based valuation function, in the minutes of all board meetings where such function is discussed.

## Section 3: Guidance for Senior Management

- A. Senior management is responsible for directing the implementation and ongoing operation of the principle-based valuation function. This includes:

1. Ensuring that an adequate infrastructure (consisting of the policies, procedures, controls, and resources) has been established to implement the principle-based valuation function.
2. Reviewing the elements of the principle-based valuation (consisting of the assumptions, methods and models used to determine PBR of the insurance company or group of insurance companies) that have been put in place, and whether these elements of the principle-based valuation appear to be consistent with, but not necessarily identical to, those for other company risk assessment processes, while recognizing potential differences in financial reporting structures and any prescribed assumptions or methods.
3. Reviewing and addressing any significant and unusual issues and/or findings in light of the results of the principle-based valuation processes and applicable sensitivity tests of the insurance company or group of insurance companies.
4. Ensuring the adoption of internal controls with respect to the principle-based valuations of the insurance company or group of insurance companies that are designed to provide reasonable assurance that all material risks inherent in the liabilities and assets subject to such valuations are included, and that such valuations are made in accordance with the *Valuation Manual* and regulatory requirements and actuarial standards. Senior management is responsible for ensuring that an annual evaluation is made of such internal controls and for communicating the results of that evaluation to the board of directors.
5. Determining that:
  - a. Resources are adequate to carry out the modeling function with skill and competence.
  - b. A process exists that ensures that models and procedures produce the intended results relative to the principle-based valuation objectives as outlined in Section 12.A of Model #820.
  - c. A process exists that validates data for determination of model input assumptions, other than input assumptions that are prescribed in law, regulation or the *Valuation Manual* for use in determining PBR.
  - d. A process exists that is appropriately designed to ensure that model input is appropriate given the experience of the insurance company or group of insurance companies, other than model inputs that are prescribed in law, regulation or the *Valuation Manual* for use in determining PBR.
  - e. A process exists that reviews principle-based valuations to find and limit material errors and material weaknesses (such process (a) to provide a credible ongoing effort to improve model performance where material errors and weaknesses exist, and (b) to include a regular cycle of model validation that includes monitoring of model performance and stability, review of model relationships, and testing of model outputs against outcomes).
  - f. A review procedure and basis for reliance on principle-based valuation processes has been established that includes consideration of reporting on the adequacy of PBR, the implementation of policies, reporting and internal controls, and the work of the appointed actuary.
6. Facilitating the board's oversight role by reporting to the board, no less frequently than annually, regarding such matters as:

- a. The infrastructure (consisting of the policies, procedures, controls and resources) that senior management has established to support the PBR actuarial valuation function.
- b. The critical risk elements of the valuation as applicable—related to the assumptions, methods and models—and their relationship to those for other risk assessment processes, noting differences in financial reporting structures and any prescribed assumptions or methods.
- c. The level of knowledge and experience of senior management personnel responsible for monitoring, controlling and auditing PBR.
- d. Reports related to governance of PBR, including:
  - i. The certification of the effectiveness of internal controls with respect to the PBR, as provided in Section 12.B.(2) of Model #820.
  - ii. The certifications from the Investment Officer on Investments and Qualified Actuary on Investments, as provided in VM-31 Sections 3.D.14.a and 3.D.14.b, and VM-31 Sections 3.F.16.a and 3.F.16.b.

#### Section 4: Responsibilities of Qualified Actuaries

- A. The responsibilities assigned by the company to one or more qualified actuaries with respect to a group of policies or contracts under Section 1.B are:

- 1. The responsibility for overseeing the calculation of PBR for that group of policies or contracts;
- 2. The responsibility for verifying that:
  - a. The assumptions, methods and models that are used in determining PBR; and
  - b. The company's documented internal standards used in the principle-based valuation processes, the company's documented internal controls and documentation used for such reserves,

appropriately reflect the requirements of the *Valuation Manual* for that group of policies or contracts. In particular, the qualified actuaries are required to certify that the assumptions used in the principle-based valuation, other than assumptions that are prescribed in the *Valuation Manual* or by law or regulation, or that pertain to risk factors that are modeled stochastically, are prudent estimates, as defined in VM-01, with appropriate margins. The qualified actuaries are not required to verify the appropriateness of any prescribed assumptions, methods or models but are required to verify that they are being used as required.

- 3. The responsibility for providing a summary report to the board and to senior management on the valuation processes used to determine and test PBR, the principle-based valuation results, the general level of conservatism incorporated into the company's PBR, the materiality of PBR in relationship to the overall liabilities of the company, and significant and unusual issues and/or findings.

If Sections 2 and 3 are not applicable because the company met the requirements to be exempt from Section 2 and Section 3 as outlined in Section 1.A, this particular reporting to board and senior management is limited to:

- a. For VM-20, notifying senior management if the company is at risk of failing either exclusion test, and if so, reporting on the company's readiness to calculate deterministic and SR; and
  - b. For VM-21, notifying senior management if the company may not be able to use the Alternative Methodology for all business subject to VM-21, and if so, reporting on the company's readiness to calculate a SR.
- 4. The responsibility for preparing the PBR Actuarial Report with respect to that group of policies or contracts, as described in VM-31.
  - 5. The responsibility for disclosing to the company's external auditors and regulators any significant unresolved issues regarding the company's PBR held with respect to that group of policies or contracts.
- B. A qualified actuary assigned responsibilities under Section 1.B with respect to a group of policies or contracts may be required to make any certification required by the *Valuation Manual*, but is not required, except in regard to any responsibilities he or she may have as the appointed actuary under VM-30, to opine upon or certify the adequacy of the aggregate reserve for that group of policies or contracts, the company's surplus or the company's future financial condition.
- C. The responsibilities of the appointed actuary are described in VM-30.