

Adopted by the Principles-Based Reserving Working Group on Sept. 22, 2009

Corporate Governance Guidance for Principle-Based Reserves – VM-G

I. INTRODUCTION AND SCOPE

1. 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.
2. For the purposes of this section:
 - i. 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;
 - ii. 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; and
 - iii. 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, chief financial officer, chief actuary, and chief risk officer) and such other senior officers as may be designated by the insurance company or group of insurance companies.

This section, while not expanding the existing legal duties of a company’s board of directors, senior management and appointed actuary and/or qualified actuaries, provides guidance that focuses on their roles in the context of principle-based reserves.

3. While existing governance standards encompass adequate and appropriate standards for oversight of principle-based reserves, the following describes guidance for the roles of the board of directors, senior management and the appointed actuary and/or other qualified actuaries, in light of their existing duties as applied in the context of principle-based reserves. It is not intended to create new duties but rather to emphasize and clarify how their duties apply to the principle-based reserves 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 shall not apply.

II. GUIDANCE FOR THE BOARD

4. Consistent with its oversight role, the board is responsible for establishing a process whereby the board: receives and reviews reports, including the certification of the effectiveness of internal controls with respect to the principle-based calculation, as provided in section 12.B.(2) of the Standard Valuation Law; interacts with senior management to resolve questions and collect additional information as needed; and determines what additional steps or direction, if any, are necessary to rely on the principle-based reserving and valuation functions established by senior management. Commensurate with the materiality of principle-based reserves in relationship to the overall risks borne by the insurance company, this process should result in general oversight of the principle-based reserves actuarial function that includes:
 - i. The process undertaken by senior management to correct any material weakness in the internal controls of the insurance company or group of insurance companies with respect to a principle-based reserve valuation if any material weakness in such internal controls is identified;
 - ii. The infrastructure (consisting of policies, procedures, controls and resources) in place to implement and oversee principle-based reserve processes; and

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- iii. The documentation of review and action undertaken by the board, relating to the principle-based reserving function, in the minutes of all board meetings where such function is discussed.

III. GUIDANCE FOR SENIOR MANAGEMENT

- 5. Senior management is responsible for the oversight of the principle-based actuarial valuation function. Oversight includes a process for senior management to perform the following functions:
 - i. Ensuring that an adequate infrastructure (consisting of the risk tolerances, policies, procedures, controls, risk management strategies, and resources) has been established to implement the principle-based reserving function;
 - ii. Reviewing the principle-based reserve elements (consisting of the assumptions, methods, and models used to determine principle-based reserves of the insurance company or group of insurance companies) that have been put in place, and whether these principle-based reserve elements 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;
 - iii. Reviewing principle-based reserving results for consistency with established risk tolerances of the insurance company or group of insurance companies in relation to the risks of the products the insurance company or group of insurance companies offers, the various strategies used to mitigate such risks, and its emerging experience, in order to understand the general level of conservatism incorporated into principle-based reserves; and
 - iv. Reviewing and addressing any significant and unusual issues and/or findings in light of the results of the principle-based reserve valuation processes and applicable sensitivity tests of the insurance company or group of insurance companies.
- 6. Senior management is responsible for adopting internal controls with respect to the principle-based reserve 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.
- 7. Senior management's responsibilities with respect to principle-based reserve valuations include determining that:
 - i. Resources are adequate to carry out the modeling function with skill and competence;
 - ii. A process exists that ensures that models and procedures produce appropriate results relative to principle-based valuation objectives (such process to provide reasonable assurance that the principle-based modeling does not produce a bias toward underestimation of such reserves, and that principle-based reserves are reasonable and adequate under the circumstances);
 - iii. 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 principle-based reserves;
 - iv. 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 principle-based reserves;
 - v. A process exists that reviews principle-based reserve 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); and
 - vi. A review procedure and basis for reliance on principle-based reserve valuation processes has been established that includes consideration of reporting on the adequacy of principle-based reserves, the implementation of policies, reporting and internal controls, and the work of the appointed actuary.

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8. Senior management is responsible for facilitating the board’s oversight duties by reporting to the board, no less frequently than annually, regarding such matters as:
 - i. The infrastructure (consisting of the risk tolerances, policies, procedures, controls, risk management strategies and resources) that senior management has established to support the principle-based reserves actuarial valuation function;
 - ii. 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;
 - iii. The summary results of principle-based reserve valuations, including the general level of conservatism and the materiality of principle-based reserves in relationship to the total liabilities of the insurance company or group of insurance companies;
 - iv. The level of knowledge and experience of senior management personnel responsible for monitoring, controlling and auditing principle-based reserves; and
 - v. Reports related to governance of principle-based reserves, including the certification of the effectiveness of internal controls with respect to the principle-based valuation, as provided in section 12.B.(2) of the Standard Valuation Law.

IV. GUIDANCE FOR QUALIFIED ACTUARIES, INCLUDING THE APPOINTED ACTUARY

9. One or more qualified actuary(ies) is (are) responsible for overseeing the calculation of principle-based reserves.
10. One of more qualified actuary(ies) is (are) responsible for reviewing and approving assumptions, methods, and models that are used in determining principle-based reserves, as well as for reviewing and approving internal standards for actuarial valuation processes, internal controls, and documentation used for such reserves. The qualified actuary(ies) does (do) not review or approve assumptions or methods that are prescribed in law, regulation, or the Valuation Manual for use in determining principle-based reserves but does (do) confirm that the prescribed assumptions and methods are being used as required.
11. With regard to principle-based reserves, the qualified actuary(ies) is (are) responsible for providing a summary report to the board and to senior management on the valuation processes used to determine and test principle-based reserves to assist their understanding of principle-based reserve valuation results, the general level of conservatism incorporated into the company’s principle-based reserves, the materiality of principle-based reserves in relationship to the overall liabilities of the company, and significant and unusual issues and/or findings.
12. The appointed actuary is responsible for providing an opinion on the adequacy of company statutory reserves, both those developed using principle-based approaches and those developed using other approaches, as part of his/her annual Statement of Actuarial Opinion.
13. The qualified actuary(ies) is (are) responsible for cooperating with the company’s internal and external auditors and regulators and is (are) responsible for working with the external auditors, regulators, and company senior management to resolve significant issues regarding the company’s principle-based reserves. This includes, but is not limited to, disclosing to such external auditors and regulators any significant unresolved issues regarding the company’s principle-based reserves.