ASP GUIDANCE NOTES (GN2017-2)

Implementation Guidelines of Life Reserve Valuation Standards

In accordance with the IC Circular 2016-66

Superseding ASP GN2015-1

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Introduction

In December 28, 2016, the Insurance Commission issued IC Circular 2016-66, Valuation Standards for Life Insurance Policy Reserves, superseding IC CL 2014-42-A, Valuation Standards for Life Insurance Policy Reserves. IC CL 2016-66 is to be implemented effective 01 January 2017, with some differences versus IC CL 20-14-42-A, the subject of an earlier ASP Guidance Notes GN2015-1. As such, the ASP Life Insurance Committee deemed it appropriate to revise ASP GN2015-1.

The Actuarial Society of the Philippines (ASP) affirms that IC Circular 2016-66 Valuation Standards for Life Insurance Policy Reserves, presents a sufficient framework of standards for the valuation of life insurance policy reserves (or statutory reserves) for regulatory reporting to the Insurance Commission.

The ASP also recognizes that the regulatory reporting is primarily for establishing and monitoring of the solvency of life insurance companies. The statutory reserves represent the measure of the company's main liability on inforce policies as at the valuation date. Risk-based capital (RBC), which is an allocation of surplus or net worth, shall be layered on top of the statutory reserves for adequate provisions for solvency.

There are differences in the principles underlying various financial reporting standards or regulations. The move to Gross Premium Valuation from Net Premium Valuation is an improvement in determining policyholder liabilities for Traditional Policies. With such change in reserving standards in place, the regulatory approach to protect policyholders from company insolvency is now more focused on requiring sufficient risk-based capital, and less focused on conservative reserves.

Guidance Notes

Guidance Notes serve the following purposes:

- Present the position of ASP on the subject matter
- Clarify certain items in the relevant regulations or standards that may have conflicting interpretations
- Supplement the regulations or standards with additional actuarial practice guidelines

- Establish consistent applications of the standards among Fellows of the ASP
- Expand guidance in order to address utilization of the principles and components of statutory reserves to related items in risk-based capital, Philippine Financial Reporting Standards, reporting of a period's realized/unrealized profit through Profit and Loss Statement (P&L) or Other Comprehensive Income (OCI), asset valuation and others
- Build guidance notes, if necessary, to become Standards of Practice

The ASP issues this Guidance Notes (GN2017-2) for compliance by all Fellows (the Actuary) certifying the basis, calculations and amounts of life insurance policy reserves in accordance with IC Circular 2016-66. ASP GN2017-2 supersedes ASP GN2015-1.

SCOPE

1. Discount Rate
2. Consistent Asset Valuation
3. Breakdown of Statutory Reserves
4. Net Premiums Due and Uncollected
5. Non-Guaranteed Benefits
6. Expenses
7. Mortality and Morbidity
8. Long Term Lapse/Surrender Rates

1. **Discount Rate**
   IC Circular 2016-66 Section IV.1, Valuation Assumptions – Discount Rate

Guidance Notes:

The pre-tax rates, gross of any final taxes and other taxes, as issued by the Insurance Commission, should be used.

Rationale:

- The discount rate is primarily a market-consistent parameter of a time value measure that is consistent with the market value basis of long term financial instruments.
- Discount rate, for purposes of reserve valuation, does not represent the expected investment income that can be generated from the supporting asset portfolio.
- Provisions for taxes are to be taken up separately in accordance with tax regulations and outside of the scope of regulatory reserve valuation.
- Only the taxes that are fully and directly proportional with the premium or benefit cash flows (such as premium tax and DST) are factored in the projected cash flows.
- Provisions for corporate income taxes should be taken up separately and outside the reserve valuation.

2. **Consistent Asset Valuation**
   IC Circular Letter 2016-65, Financial Reporting Framework under Section 189 of the Amended Insurance Code (Republic Act No. 10607), issued December 28, 2016
   Section 2.11. Section 214

Guidance Notes:

For purposes of establishing an appropriate value of Net Worth (Assets – Liabilities) upon adoption of Gross Premium Valuation (GPV) on statutory reserves, the Actuary is encouraged to recommend to the company to classify fixed income assets supporting policy reserves as Available-For-Sale (AFS), whenever such classification is allowed under PFRS.

Rationale:

The GPV methodology using market-consistent discount rates in the determination of actuarial reserves is consistent with the AFS valuation of assets if changes in reserves resulting purely from changes in discount rates are excluded from the income statement. The GPV methodology on liabilities will yield misleading net worth values when a material amount of supporting assets is not valued at market interest rates, such as those assets classified as held-to-maturity (HTM). It is important for assets to be valued at market-consistent discount rates to be consistent with the GPV reserve liability, which is valued at market discount rates.

The basis of the Actuary's recommendation on the asset classification for valuation basis of assets supporting actuarial reserve liabilities and related surplus reserves is the following overarching principle stated in:

IC Circular Letter 2016-65, Financial Reporting Framework under Section 189 of the Amended Insurance Code (Republic Act No. 10607), issued December 28, 2016
Section 2.11. Section 214
Paragraph (h)

"Notwithstanding any provision contained in this section or elsewhere in this chapter, if the Commissioner finds that the interests of policyholders so permit or require, he may permit or require any class or classes of insurers authorized to do business in this country to value their investments or any class or classes thereof as of any date heretofore or hereafter in accordance with any applicable valuation or method."

3. Breakdown of Statutory Reserves

IC Circular 2016-66 Annex B, Actuarial Valuation Results

Guidance Notes:

The Actuary is also responsible for the demonstration of:

A. The impact on reserves due to changes in:
   a. The insurance policy portfolio over the relevant period,
   b. Valuation methodology
   c. Best-estimate assumptions
   d. Provisions for adverse deviations
   e. Market-consistent parameters
   f. Business models and nature of contractual obligations
B. Components of statutory reserves that may be utilized for financial reporting under PFRS and other local regulations

The order of presentation should follow the format as prescribed by IC CL 2016-66 or by any subsequent circular and/or advisory issued by the Insurance Commission on this subject.

Rationale:

For purposes of analysis and demonstration, the actuary may refer to the definitions presented in the appendix to the Guidance Notes. The order of breakdown into components of increases in reserves is primarily in accordance with accounting rules, rather than a matter of actuarial principle. In any case, the actuary should ensure that statutory reserve balances are properly recognized in the company's financial statements.

However, regardless of details and order of presentation required for regulatory reporting, the actuary should analyze and be able to disclose the components of increases in reserves to ensure that reserve provisions are adequate and company management is able to understand the nature and behavior of the business portfolio and make appropriate, informed decisions.

Further, where the company performs valuations more frequently than that required by the Insurance Commission, the actuary should adjust the reportorial tables and accompanying formulas as necessary.

4. Net Premiums Due and Uncollected
IC Circular 11/91 Net Premiums Due and Uncollected, issued May 28, 1991.

Guidance Notes:

Under Gross Premium Valuation, the asset Net Premiums Due and Uncollected should be calculated as:

> Gross Premiums Due and Uncollected, less Cost of Collection such as, but not limited to, commissions, overrides and incentives, premium taxes, and other percentage of premium expenses.

5. Non-Guaranteed Benefits

IC Circular 2016-66 Section IV.2, Valuation Assumptions – Non-Guaranteed Benefits

Guidance Notes:

The Actuary should determine the value of reserves for non-guaranteed benefits and policyholder dividends using, to the extent possible, consistent and verifiable basis of the following parameters:

1. Current scales of prospective non-guaranteed benefits or policyholder dividends.

   These shall mean:
   a. On products being marketed during the relevant reporting period, the scales appearing in sales illustrations
   b. On products which are no longer marketed during the relevant reporting period, the scales in the following order of relevance:
      i. Recently approved by the Board of Directors
      ii. Applied as the basis of most recent non-guaranteed benefits or policyholder dividends provided to policyholders
      iii. Currently stored in the administration system of the company
      iv. Used in the last set of the product's sales illustration

2. Discount rate. This shall mean the discount rates prescribed under IC CL 2016-66 Section IV.1 Discount Rates.

   Rationale:

   - IC CL 2016-66 does not provide any leeway to change the discount rates used for computing the GPV for non-guaranteed benefits.
   - As stated in Section 1 of this Guidance Notes, the discount rate is primarily a market-consistent parameter of a time value measure that is consistent with the market value basis of long term financial instruments.
   - Further, the discount rate, for purposes of reserve valuation, does not represent the expected investment income that can be generated from the supporting asset portfolio.

The Actuary should disclose:
- The discount rate used
- The scale of rates of non-guaranteed benefits or policyholder dividends for all prospective years on a policy with issue age 35 (or other representative age) of the product with one of the most significant reserve amounts for non-guaranteed benefits
- Any changes in assumptions and basis from those in the prior year

6. Expenses

IC Circular 2016-66 Section IV.3, Valuation Assumptions – Expenses

Guidance Notes

The Actuary should select best estimate assumptions which provide for expenses of the relevant policies, including overhead, after valuation date. The basis for the determination of expense assumptions should be the company's current experience.

Should there be an expectation of lower unit expenses in the future, the Actuary may assume a justifiable, systematic grading of unit expenses. Such grading of expense assumption should be done only if the actuary believes that unit expenses assumptions are expected to reduce in the future, in consideration of future economies of scale or expense efficiencies are expected to be achieved. If the actuary is assuming unit expenses that are below actual expense experience, the Actuary should consider including provisions for expense overruns in the cash flow projections.

Inflation assumptions should be used in projecting expenses, whenever appropriate.

7. Mortality and Morbidity

Guidance Notes

The basis for selecting mortality and morbidity assumptions should be the company's actual experience and the nature of risks covered. Where actual experience is inappropriate to be used, the Actuary should first consider using mortality and morbidity tables derived from local market experience and ideally recognized by the Insurance Commission, such as, but not limited to:

- 2017 Philippine Intercompany Mortality Study,
- Mortality and morbidity tables that have been or may be published by the Actuarial Society of the Philippines.

modified as deemed appropriate for the nature of risks insured by the company.

8. Long Term Lapse/Surrender Rates

IC Circular 2016-66 Section IV 5., Valuation Assumptions – Lapse and/or Persistency

Guidance Notes

It is generally recognized that the rates of lapses, surrenders and persistency are largely dependent on macroeconomic factors, policyholder characteristics and parameters internal or specific to the company such as the product (premium term, benefits, non-forfeiture options), distribution channel, service level, etc.

Also, the volume of relevant past experience on long term lapse rates is very slow to develop.

It is therefore difficult to establish a credible basis for long term lapse rate assumptions. The overriding consideration is the consistency of assumption adopted by actuaries in the absence of adequate basis for the assumption.

The Actuary may use a best-estimate long term lapse rate between 0% to 3% p.a. for the following policy characteristics without having to justify with the rationale or establishing credibility from insufficient volume of relevant policy experience:

1. Policies already on paid-up period
2. Policies during the premium payment period but beyond the 5th policy anniversary

The Actuary however may use a best-estimate long term lapse rate outside the 0% to 3% range if the assumption is supported with sufficiently credible experience basis or if the Actuary can make declarations of a strong rationale for doing so.

Provisions for adverse deviation shall be added in accordance with the IC Circular 2016-66.

This does not preclude the company in building relevant experience to support the adoption of a more credible long term lapse assumption.

APPENDIX

For purposes of analysis and demonstration, the Actuary should present the breakdown of total statutory reserves by line of business:

I. During the transition period up to the date of the adoption of GPV, the Actuary may be required to present the following reserve amounts:

	As of End of Prior Period	As of End of Current Period	Amount Increase
Reserves under Net Premium Methodology (NPV)			
Reserves under Gross Premium Methodology (GPV)			
Reserves NPV – GPV			
Unearned Premium Reserves (UPR)			
Negative GPV Reserves with MFAD			
Reserves for Non-Guaranteed Benefits and Policyholder Dividends			
Net Premiums Due under NPV			
Net Premiums Due under GPV			
Net Premiums Due NPV – GPV			

While UPR is presented separately, it is understood that UPR in principle is the GPV reserves for short-term insurance contracts, including those renewable at non-guaranteed premium rates. The UPR should contain, when appropriate, provisions for adverse deviations consistent with other classes of policies.

II. During and beyond the transition period, the Actuary should present, but not limited to, the reserve amounts shown in the following table:

II. Impact of Change in Assumptions under GPV

		As of End of Prior Period					As of End of Current Period		
		Reserves as of End of Prior Period (A)	Reserves using Current Period discount rate (B)	Increase in Reserves due to change in discount rate (C) = (B) - (A)	Reserves using Current Period assumptions including discount rate (D)	Increase in Reserves due to changes in assumptions other than discount rate (E) = (D) - (B)	Reserves using Current Period assumptions including discount rate (F)	Increase in Reserves due to change in in-force file (G) = (F) - (D)	Total Increase in Reserves (H) = (C) + (E) + (G)
Policy Reserves									
(1)	Total Policy Reserves after basis change (2) + (3)	-	-	-	-	-	-	-	-
(2)	GPV Reserves with Margin for Adverse Deviations (MfAD)			-		-		-	-
(3)	Unearned Premium Reserves			-		-		-	-
(4)	GPV Reserves without MfAD			-		-		-	-
(5)	Impact of MfAD (2) - (4)			-		-		-	-
(6)	Negative GPV Reserves			-		-		-	-
(7)	GPV Reserves for Non-Guaranteed Benefits and Policyholder Dividends			-		-		-	-

Notes:
1. In Table I, GPV Reserves shall include Unearned Premium Reserves.
2. In Table II, the discount rates to be used for columns B, D and F shall be the IC-prescribed discount rates as of end of current period.
3. Item 3 of Table I must tally with Item 1 Column A of Table II.
4. Item 6 of Table I must tally with Item 1 Column F of Table II.
5. Item 7 of Table I must tally with Item 1 Column H of Table II.