Republic of the Philippines
Department of Finance
INSURANCE COMMISSION
1071 United Nations Avenue
Manila

Circular No.	:	2014-42-A
Date	:	October 30, 2014

CIRCULAR LETTER

TO : **ALL LIFE INSURANCE COMPANIES AND MUTUAL BENEFIT ASSOCIATIONS DOING BUSINESS IN THE PHILIPPINES**

SUBJECT : **VALUATION STANDARDS FOR LIFE INSURANCE POLICY RESERVES**

Pursuant to Sections 216 and 423 of the Amended Insurance Code (RA 10607), attached is the new set of valuation standards for life insurance policy reserves.

For 2014 and 2015 year-end valuations, parallel runs using both the existing and the new valuation standards shall be done. However, for balance sheet and financial reporting purposes the existing valuation standards shall still apply for 2014 while this new set of valuation standards shall apply starting 2015 and thereafter. Nonetheless, figures obtained for the 2-year parallel runs using both the existing and new valuation standards shall be reported to this Commission for evaluation.

EMMANUEL F. DOOC
Insurance Commissioner

Republic of the Philippines
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Valuation Standards for Life Insurance Policy Reserves

I. Introduction

1. A life insurance company must value the policy reserves of its life business at the end of each calendar year as required by the Insurance Commission (IC), in accordance with this set of Valuation Standards for Life Insurance Policy Reserves.

2. The methods and valuation assumptions must:

    a. be appropriate to the type of business and its risk profile;
    b. include appropriate margins for adverse deviations in respect of the risks that arise under the insurance policy;
    c. be in accordance with the internationally accepted actuarial standards; and
    d. consider the generally accepted actuarial principles concerning financial reporting framework promulgated by the Actuarial Society of the Philippines (ASP).

3. Unless the context otherwise requires, the following terms shall be taken to mean:

    a. "variable contract" is as defined in Section 238 (b) of the Amended Insurance Code (RA 10607)
    b. "traditional policy" is a policy other than variable contract, which includes life, health or accident, annuity contracts and supplementary benefits or riders
    c. "company" is a life insurance company supervised by the IC.

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II. Valuation Methodology

1. An actuary duly accredited by the IC shall be responsible in determining the level of policy reserves based on his professional valuation of the company's life insurance liabilities using a basis no less stringent than that prescribed in the following paragraphs.

2. Subject to paragraphs 3 to 5 below, the reserves for traditional life insurance policies must be valued, where appropriate, using gross premium valuation. This is calculated as the sum of the present value of future benefits and expenses, less the present value of future gross premiums arising from the policy discounted at the appropriate risk-free discount rate. For this purpose, the expected future cash flows shall be determined using best estimate assumptions with due regard to significant recent experience and appropriate margin for adverse deviation from the expected experience.

3. For any traditional life insurance policy where the guaranteed cash value as at valuation date is greater than zero, the reserve calculated based on paragraph 2 must be floored at the guaranteed cash value.

4. For any traditional life insurance policy where the guaranteed cash value as at valuation date is zero, and the corresponding reserve calculated based on paragraph 2 is negative, the company must appropriate from the unassigned surplus an amount equal to the aggregate of the negative reserves calculated on a per policy basis.

5. For any traditional life insurance policy with a term of one year or less, the reserve shall be calculated using the unearned premium method.

6. A company shall value the reserves for variable life insurance contracts as the sum of the:

   a. market value of the underlying assets backing the separate accounts relating to the policy, excluding any seed capital; and
   b. unearned cost of insurance or unearned risk charge.

7. A more conservative basis of valuation may be adopted by the Actuary resulting in higher policy reserves compared to the standards set out above, if, in his professional judgment, it is appropriate to do so.

8. Where the reserve of a life insurance policy cannot be appropriately valued using this set of valuation standards, the valuation shall be done using the basis approved by the IC.

III. Data and Systems

1. The company's Chief Executive Officer (CEO), or responsible officer with a rank of at least Vice President or its equivalent, shall ensure that the company's database is properly maintained so that the data on business in force is accurate and complete. The CEO or the responsible officer shall furnish the data to the actuary and grant him/her reasonable access to its database.

2. Reasonable tests shall be applied on the data to check both its integrity and completeness before starting the valuation process.

IV. Valuation Assumptions

1. Discount Rates

a. The risk-free discount rate shall be used for all cash flows to determine the liability of a traditional life insurance policy.

b. The yield curve used as basis for the risk-free discount rate shall be obtained from the following sources:

   i. for Philippine Peso policies : PDST-R2 rates
   ii. for US Dollar policies: International Yield Curve (IYC) from Bloomberg

c. The risk-free discount rate shall be the equivalent zero-coupon spot yield of the above yield curve with matching duration. Duration is the term to maturity of each future cash flow.

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d. If the duration of the cashflow is more than that of the longest available bond, then the discount rate shall be based on the longest bond yield rate.

e. Where yields at certain durations are not available, these yields shall be appropriately interpolated from available information.

f. The IC will provide the yield curve and risk-free discount rate annually, and may change the sources of the yield curve when appropriate.

2. Non-guaranteed Benefits

The level of non-guaranteed benefits under traditional life insurance policies to be valued, including policy dividends, shall be determined with due regard to the company's duty to treat its policyholders fairly and meet policyholders' reasonable expectations.

3. Expenses

a. The expense assumptions shall be based on the company's experience derived from its latest expense study. Otherwise, basis and justification of the assumptions used must be provided.

b. Suitable non-negative expense inflation rate shall be used. All projected expected expenses shall be recognized in the valuation process.

4. Mortality and Morbidity

The mortality and morbidity assumptions shall be based on rates of mortality and morbidity that are appropriate to the nature of the risks covered based on the company's actual experience. If actual experience is not available or if the company's actual experience is inappropriate to be used, the basis and justification for the assumptions used must be provided.

5. Lapse and/or Persistency

The lapse and/or persistency rates reflective of the company's actual experience shall be taken as the best estimate lapse and/or persistency assumption, with due regard to changing company practices and market conditions. If lapse and/or persistency experience is not yet available, the basis and justification for the assumption used must be provided.

V. Margin for Adverse Deviation (MfAD)

1. Fixed margins for adverse deviations (MfAD) will be used subject to a minimum of:

    a. Interest: +/-10% of discount rate

    b. Expense: 10% of best estimate expenses

    c. Other assumptions including but not limited to mortality, morbidity, lapse and conversion: +/-10% of best estimate assumptions

2. For mortality and lapse assumptions, the sign (positive or negative) of MfAD should be tested per group of products at the time of valuation. MfAD will have the same sign for all durations per group of products. The product grouping shall be whole life, endowment and term.

3. For interest assumption, the sign (positive or negative) of MfAD should be tested on aggregate basis.

4. The MfAD on expenses will be on expense components that are exposed to uncertainty. The commissions payable to agents/distributors and taxes may not be subject to MfAD.

5. The provision for adverse deviation or the additional reserves due to the MfAD for each component (i.e., expense, mortality/morbidity, lapse, interest) must be non-negative.

6. Any change in the level of MfAD used must be justified.

VI. Actuarial Valuation Report

1. The Report on Actuarial Valuation of Life Insurance Policy Reserves shall follow the format and contain the minimum information set out in **Annex A**.

2. The Certifications to be provided by the Actuary and the Chief Executive Officer or responsible officer shall be duly notarized.

VII. Application

This set of Valuation Standards shall apply to all policies issued by life insurance companies and mutual benefit associations.

Annex A

Report on Actuarial Valuation of Life Insurance Policy Reserves
Name of Company: ______________________
For the period ended dd/mm/yyyy

Section A: Data on In Force Policies

Describe the following:

a. Steps taken to verify consistency, completeness and accuracy of data

b. Adjustments made to the data and rationale for such adjustments

Section B: Valuation Methodology

1. Describe the valuation method used

2. If methods used are different from those prescribed in this set of valuation standards, provide a detailed description of each method, including, but not limited to:

    a. Scope of application including policies/products covered

    b. How the method works including formula

    c. Disclosure of any approximation or simplification made

    d. Justification for the use of said method

    e. Document evidencing approval by the IC

3. Provide details of any change in the valuation methods used since the last valuation date and quantify impact of the change.

Section C: Valuation Assumptions

1. State and provide justification for the key assumptions.

2. Disclose and justify any material change in assumption from the previous valuation and quantify the impact of each change.

Section D: Margin for Adverse Deviations (MfADs)

1. State the MfAD used per assumption or parameter, and provide rationale if different from the minimum prescribed in this set of valuation standards

2. Provide justification of any change in MfAD used from last valuation date and quantify the impact of each change.

Section E: Others

1. Document the extent of compliance with the requirements of this set of valuation standards and the reasons for non-compliance, if any.

2. Define terms and expressions used in the Report on Actuarial Valuation which may be ambiguous or subject to wide interpretation.

Section F: Valuation Results

The summary of the valuation results shall follow the format shown in **Annex B.**

Section G: Certification by the Actuary

The Actuary shall provide a certification as set out below:

> "I hereby certify that I have conducted tests necessary to verify the reasonableness and integrity of the data, confirm that the information contained in this Report are accurate to the best of my knowledge and that I have calculated the policy reserves in accordance with the Valuation Standards prescribed by the Insurance Commission and the standards of practice of the Actuarial Society of the Philippines.
>
> ____________________________________
> Signature over Printed Name of Actuary
> Date : ________________________"

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Section H: Certification by the CEO or Responsible Officer

The CEO/Responsible Officer shall provide the following certification:

> " I hereby certify that the database is properly maintained and I have satisfied myself that the data provided to the certifying Actuary are accurate and complete.

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Signature over Printed Name
of Chief Executive Officer/Responsible Officer

Date : __________________________ "

Annex B

Actuarial Valuation Results
Life Insurance Policy Reserves in Philippine Peso
For the period ended dd/mmm/yyyy

Summary of Valuation Results

	Traditional	**Variable**	**Total**
Policy Reserves			
Before basis change			
After basis change			
Impact of change			
Negative Reserves			