



## **Report of the Annuity Reserves Work Group to the Life Actuarial Task Force on Possible AG 33 Reserve Solution for GLIB Business**

**November 27, 2012**

The Annuity Reserves Work Group (ARWG) of the American Academy of Actuaries<sup>1</sup> has closely followed the deliberations of the Fixed Annuity Subgroup of the Life Actuarial Task Force (LATF) since the ARWG alerted LATF of potential reserve problems for fixed annuities with Guaranteed Lifetime Income Benefits (GLIBs) at its Spring 2012 National Meeting in New Orleans. Until now, the ARWG has not made a recommendation to LATF or the Fixed Annuity Subgroup regarding a reserve methodology to be employed as a temporary solution to any reserve problem prior to the effective date of VM-22. We did provide an Excel reserve calculation workbook to the Fixed Annuity Subgroup along with sample calculations to aid in its analysis of the issue. Just as LATF has articulated, the ARWG believes the best long term solution to this reserve issue is a principle-based approach. The ARWG is working hard to deliver an initial draft of VM-22 for LATF to consider in 2013. However, should LATF decide to move forward with a temporary solution to the fixed annuities with GLIB issue, the ARWG recommends that it be accomplished by modifying Actuarial Guideline XXXIII (AG 33) instead of Actuarial Guideline XLIII (AG 43).

### **Reasons to Modify AG 33 as the Temporary Solution**

- We are investigating a formulation of a Deterministic Reserve under VM-22 for policies with either guaranteed living benefits and/or guaranteed death benefits in excess of the accumulation value (GL/DBs). It is based on AG 33 with prescribed policyowner election and lapse rates for Integrated Benefit Streams involving GL/DBs. We believe such a reserve could potentially comply with the existing Internal Revenue Code treatment of life insurance reserves. If it would be helpful to LATF to receive an early draft of this part of VM-22, we would be happy to provide it as quickly as it becomes ready.
- Since the ARWG may recommend an AG 33-based Deterministic Reserve, we recommend that LATF pursue the development of similar modifications to AG 33. Such a modification could be used for annuities incorporating or optionally including GL/DBs<sup>2</sup> and could also

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<sup>1</sup> The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

<sup>2</sup> Note that this approach means that all the Integrated Benefit Streams that do not incorporate GLIB withdrawal or death benefit guarantees will still be reflected in CARVM's Greatest Present Value as is currently required (i.e. without election and lapse rates). Thus, insurers cannot incorporate GLIBs just to gain the benefit of election and lapse rates as those rates would not be incorporated in the non-GLIB Integrated Benefit Streams. Death benefits in excess of the accumulation value would still utilize prescribed mortality rates, and if the benefits are contingent upon election of an option in the policy then the election rates and possibly lapse rates would still apply.

include the requirement proposed by some members of LATF that companies using the election rates (and possibly lapse rates) also perform a stand-alone asset adequacy test. This would be a step towards the VM-22 Deterministic Reserve and would provide continuity of the reserving approach for GL/DB business. The ARWG has already developed preliminary language to implement such modifications in AG 33.

### **Reasons Not to Modify AG 43 as the Temporary Solution**

The ARWG believes both fixed and variable annuities can ultimately use the same principle-based approach for reserves. However, given the process undertaken to develop these requirements and the current focus of AG 43/VM-21 and VM-22, it is appropriate for the initial version of the Valuation Manual to have separate chapters for these two product lines in order to adequately address their major differences:

- VM-21 to have as its major focus addressing equity market risks of Separate Account products having living and death benefit guarantees, and
- VM-22 to have as its major focus addressing interest rate risks of all General Account-only annuity products and their guaranteed living and death benefits.

The ARWG is concerned that if LATF elects to address the need for a temporary valuation solution for GLIBs by modifying the scope of AG 43, it could ultimately result in the elimination of VM-22 and the broadening of the scope of VM-21 to include all annuity business. This is because insurers that write GLIB business could be reluctant to have VM-22's Deterministic Reserve apply to business written after VM-22 becomes effective because both the statutory basis and the presumed tax reserve basis would then change, and this may not be optimal – either for them or to the Treasury Department. Thus, insurers would want to broaden the scope of VM-21 to have it apply to their business, thus bifurcating the non-variable annuity business, with part of it covered under VM-21 and the rest covered under VM-22. Insurers would then be able to engineer GL/DB-like provisions in fixed annuities to cause them to be valued under VM-21 or VM-22, depending on which one offers them the most attractive reserves. This could very well lead to an outcome of eliminating VM-22 altogether by just broadening the scope of VM-21 to include all annuity business.

Should this occur, non-variable annuity reserve issues could be overshadowed by variable annuity issues in the process of adapting VM-21 to cover non-variable annuities. In addition, PBR for non-variable annuities might then be delayed considerably (beyond the timeline that currently appears possible) due to the additional complexities of creating a single set of guidance that covers both variable and non-variable annuity risks. It could even be further delayed if the development of this guidance was swept into the valuation and RBC issues currently under review by the C3-Phase 2 / AG 43 joint subgroup of the Capital Adequacy (E) Task Force and LATF.

For all of these reasons, the ARWG considers an expedient solution now that impairs development of PBR for non-variable annuities over the longer term to be the wrong approach.

## **Summary**

To develop consistent valuation approaches for fixed annuities, both before and after adoption of VM-22, and in order to avoid a potential series of events that would present hurdles to the development and adoption of VM-22, we recommend that any interim solution be accomplished by modifying AG 33 rather than modifying AG 43.

We are happy to discuss these recommendations further.