



AMERICAN ACADEMY *of* ACTUARIES

September 30, 2013

David Hippen
Chair – AG 43 / C-3 Phase II Subgroup
National Association of Insurance Commissioners (NAIC)

Dear Mr. Hippen:

The American Academy of Actuaries¹ AG 43/C-3 Phase II Work Group (Academy Work Group) has reviewed Amendment Proposal Form AG43_NY_Calib_Volatil_1 (APF), which proposes modifications to the current Total Return Gross Wealth Ratios in section A5.2 of Actuarial Guideline 43, and we raise the following questions of concern for the NAIC C-3 Phase II/AG 43 (E/A) Subgroup (NAIC Subgroup) to consider:

1. It appears to the Academy Work Group that the rationale for the APF is based on the perception that equity markets have recently become more volatile. However, it was reported on the August 25 NAIC Subgroup conference call that the modifications in the proposal are based on empirical data going back to 1928. Thus, it appears that the approach being proposed is inconsistent with concerns involving recent trends. If the intent is to address the perception of recent volatility, what is the rationale for going back to 1928 to determine the proposed one-year gross wealth ratios?

There are many reasons why data from the 1920-30s may not be directly relevant to "present day" forward projections for statutory reserve and risk-based capital calculations (e.g., the equity market is much more diversified, regulated and efficient today), not the least of which is that data prior to 1957 have to be estimated since the S&P500 index didn't exist before then.

2. The proposed five-, ten-, and twenty-year gross wealth ratios were reportedly developed by determining the ratio of the proposed one-year gross wealth ratios to the current one-year gross wealth ratios and applying that ratio to the current five-, ten-, and twenty-year gross wealth ratios. What is the basis for that approach? What statistical/distributional assumptions were made in applying such a ratio approach?
3. If going back to 1928 to determine proposed gross wealth ratios and applying ratios to determine the remaining gross wealth ratios is considered a reasonable approach, why was that approach only used at the 2.5%, 5% and 10% percentile levels? Why wasn't that approach applied to the 90%, 95%, 97.5% percentile levels?
4. The Academy work group that assisted in the development of the current calibration criteria has demonstrated that scenarios meeting the criteria could be produced by applying several

¹ The American Academy of Actuaries is a 17,500-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.

statistical distributions (such as Independent Lognormal, Regime Switching Lognormal, and Stochastic Lognormal Volatility) with specified parameters. These statistical distributions were provided for three main purposes: to be used as a reasonability check, to allow companies to be able to use standard statistical distribution functions when developing their own scenarios, and to facilitate the development of the pre-packaged scenarios. Has the proposed calibration criteria been tied to any statistical distributions, and if so, are the resulting statistical distributions reasonable?

We are available to discuss these questions during the next NAIC Subgroup call or at your convenience. Please feel free to contact John Meetz, the Academy's life policy analyst (meetz@actuary.org; 202/223-8196) if you have any questions.

Sincerely,

Tom Campbell, Chairperson
Actuarial Guideline 43/C-3 Phase II Work Group
American Academy of Actuaries