



AMERICAN ACADEMY of ACTUARIES

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March 15, 2021

Honorable Bruce Sartain, Chair
Valuation Manual (VM)-22 (A) Subgroup
National Association of Insurance Commissioners (NAIC)

Dear Mr. Sartain,

The American Academy of Actuaries¹ Annuity Reserves Work Group (ARWG) presented a fixed annuity principle-based reserving (PBR) framework proposal on the October 21, 2020, NAIC VM-22 Subgroup call. The work group subsequently received a request from you to provide a summary of the differences between the proposal and current framework for VM-21 (variable annuity PBR). Furthermore, it was asked whether each deviation from VM-21 could be classified as either a change that would be specific to fixed annuity PBR or a change that the ARWG would recommend making to VM-21 and VM-20 (life PBR) as well for future versions of the NAIC Valuation Manual. The ARWG (now, Annuity Reserves and Capital Work Group [ARCWG]) worked with the chairpersons of the Academy's Life Reserves Work Group (LRWG) and Variable Annuity Reserves and Capital Work Group (VARCWG) to come up with the following grid.

We ask for the VM-22 Subgroup's consideration to include this grid as a supplement to the exposed [ARWG Preliminary Framework \(October 2020\)](#) on fixed annuity PBR, which may provide more clarity to regulators and interested parties in their consideration of the Framework.

Please let us know if you have any follow-up inquiries in response to this document. Again, we appreciate the opportunity to present the fixed annuity framework and all of the efforts made by the NAIC VM-22 Subgroup to focus on this topic.

Sincerely,
Ben Slutsker
Chairperson, Annuity Reserves and Capital Work Group
American Academy of Actuaries

CC: Reggie Mazyck, NAIC

¹ The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

Fixed Annuity PBR Deviations from VM-21

Description: This grid summarizes deviations between the proposed ARWG fixed annuity PBR framework and the current VM-21 requirements. The remaining framework elements not listed in this grid are generally proposed to be the same as the current VM-21 requirements. A description and rationale for the proposed deviations are provided, along with a suggestion for whether each item should be explored for possible updates to VM-20 and VM-21 going forward as well.

#	Element	Description of how Proposed deviates from current VM-21 requirements	Rationale for Proposed compared to current VM-21	Suggest to consider applying update to VM-21?	Suggest to consider applying update to VM-20?	Rationale for whether to update VM-20/21
1	Reinvestment Assumption	Limits on general account reinvestment mix for new money; recommend changing from 50% AA / 50% A to the current VM-22 reinvestment mix	Thought is to set more in line with the current industry mix	Yes	Yes	General accounts on VAs should be same as fixed annuities; also consider for VM-20
2	Index Credit Hedge Method	Model a best efforts CTE70 amount with breakage expense to reflect index credit hedge error, rather than requiring an adjusted CTE70	Hedging program largely specific to fixed index annuities rather than variable annuities ¹	No	No	Less relevant for VAs and there is already a separate treatment established for life requirements ²
3	Index Credit Hedge Error	Minimum hedging error for hedging programs that specifically support products with index-based credits (not other hedging programs)	Hedging program largely specific to fixed index annuities rather than Variable Annuities ¹	No	No	Less relevant for VAs and there is already a separate treatment established for life requirements ²
4	Model Hedges Regardless of CDHS	Require seasoned hedging programs to be modeled in future cash flows, regardless of whether or not considered a CDHS	Would prevent only including hedging if reducing reserves	Yes	Yes	Applicable to both life and variable annuity reserve requirements as well
5	Borrowing Cost Safe Harbor	Safe harbor to use negative new money reinvestment rates as the cap on negative net asset earned rate when borrowing in later years	Assets may run out in later years, leading to an inappropriately large discount rate	Yes	Yes	Same issue that prompted safe harbor proposal also exists in VM-20/VM-21
6	Exclusion Test	Exclusion testing option to use prior CARVM requirements, including AGs, using an approach that measures the level of risk inherent within contracts	Propose exclusion test instead of Alternative Methodology for assessing PBR applicability	No	No	VM-21 has alternative methodology; VM-20 has exclusion test
7	Policy Allocation	Propose different policy allocation method that allocates aggregate reserves in excess of cash surrender value to each contract	Differences in how tax reserve deductibility between variable and non-variable contracts	No	No	VM-20/VM-21 already have allocation methods that are appropriate given tax requirements
8	Policy Loans	Include guidance and considerations for how to model policy loans explicitly and through asset approximations based on VM-20	Loans exist on VAs, but no clear advantage if not included	No	No	No clear advantages in current VM-21 wording; VM-20 already has this wording
9	Non-Guaranteed Elements (NGEs)	Include guidance around non-guaranteed elements based on VM-20	NGEs less prevalent on VAs; use of actuarial judgement	Maybe	No	NGEs less prevalent on VAs; VM-20 already has this wording
10	Supplemental Benefits	Provide more guidance around when PBR addresses riders and supplemental benefits (possibly in VM Section II)	Supplemental benefits & riders treatment clarified on whether to value with the base policy	Maybe	No	Supplemental benefits & riders also exist on VA contracts; life reserve requirements already address
11	Aggregation Principles	Propose allowing aggregation across various fixed annuity contracts, but clarify a list of principles under which aggregation is appropriate or not	Given the variety of fixed annuities: (index, deferred, payout), there is a need to outline principles	No	Maybe	Less contract variety for VAs than fixed annuities; may be relevant to life
12	Product Scope	Fixed annuity PBR would apply to only non-variable annuity contracts	Scope of products to focus on non-variable annuity contracts	No	No	Scope of products is different; ARWG/ARCWG still reviewing hybrid VA/fixed contracts

VA = Variable Annuity CDHS = Clearly Defined Hedging Strategy CARVM = Commissioners Annuity Reserve Valuation Method VM = Valuation Manual AGs = Actuarial Guidelines

(1) The ARWG fixed annuity framework proposes to only set this treatment for programs supporting index credits. There is a separate treatment proposed for future hedging programs that follow guaranteed living benefits and other liabilities, which is to follow the methodology laid out in VM-21 requirements for future hedging programs.

(2) For indexed universal life (IUL), VM-20 also requires a deterministic reserve (subject to exclusion testing). In 2019, VM-20 was amended to set the crediting rate in the deterministic reserve based on the methodology outlined in AG36. With no deterministic reserve, this treatment is not applicable to VM-22. In addition, VM-20 only requires hedging to be included in future cash flows if the program is a CDHS. VM-20 also prohibits exclusion testing for blocks with CDHS programs.