What is VM-22?

VM-22 refers to Section 22 of the National Association of Insurance Commissioners (NAIC) Valuation Manual, which currently specifies new interest rate requirements for reserves on single premium immediate annuities and similar contracts.[1]

Why are the revisions needed?

The methodology used to determine maximum interest rates for payout annuity statutory reserves were originally developed in 1986, when the interest rate environment was much different than today. For example, the 1986 formula contained a minimum floor of 3% for statutory reserves. This became an issue when interest rates decreased and it became plausible that some companies may not earn a minimum of 3% interest net of expenses and defaults. The goal of VM-22 was and is to better match the reserve valuation rates with the investment rates a company could earn on assets supporting product liabilities in the current interest rate environment.

What policies/insurance products do the new interest rates apply to?

The interest rates apply to the following contracts issued after December 31, 2017:

- Immediate annuity contracts;
- Deferred income annuity contracts;
- Structured settlements in payout or deferred status;
- Fixed payout annuities resulting from settlement options or annuitizations of other contracts;
- Supplementary contracts;
- Fixed income payment streams, attributable to contingent deferred annuities (CDAs) once the underlying contract funds are exhausted;
- Fixed income payment streams attributable to guaranteed living benefits associated with deferred annuity contracts, once the contract funds are exhausted; and
- Certificates from non-variable group annuity contracts purchased to provide certificate holders benefits upon their retirement

Generally, all companies with contracts falling within the scope of the above must comply with VM-22,[2] but state valuation laws should be consulted.

1 It is expected that VM-22 will also contain reserve requirements for fixed annuities. This part of VM-22 is still being worked on, and is expected to become requirements in 2023.
2 The New York requirements are different. Please refer to NYDFS Regulation 213 for specifics of the New York requirements.

VM-22 only provides guidance for the discount rate input used in the statutory reserve calculation—it does not pertain to the entire reserve calculation methodology.

Is VM-22 principle-based reserves for fixed annuities?

No, the VM-22 requirements that went into effect on Jan. 1, 2018, are not the same as principle-based reserves for fixed annuities. In this respect, VM-22 is different than VM-20 (principle-based reserves for life products) and VM-21 (principle-based reserves for variable annuities). Further, unlike VM-20 and VM-21, **VM-22 only provides guidance for the discount rate input used in the statutory reserve calculation—it does not pertain to the entire reserve calculation methodology**. The reserve methodology for fixed annuities is specified under the Commissioners Annuity Reserve Valuation Method (CARVM) or, for certain contracts, the Commissioners Reserve Valuation Method (CRVM) in the Standard Valuation Law (SVL). A process is currently underway where the NAIC is exploring whether to include a fixed annuity principle-based reserve method in the Valuation Manual, but this is currently not in place.

What are the different interest rate buckets under VM-22?

There are two main categories:

1. Jumbo contracts, which are contracts greater than or equal to $250 million. Valuation interest rates for jumbo contracts are determined daily.
2. Non-jumbo contracts, which have initial considerations less than $250 million. Valuation interest rate for non-jumbo contracts are determined quarterly.

Within these categories, there are valuation interest rate buckets. For both categories, there are four reference period buckets; reference period is defined as the length of time from the premium determination date to the date of the last payment that is not dependent on the annuitant being alive. For contracts that pay benefits that depend on the annuitant being alive,[3] there are reference period buckets that also depend on the age of the annuitant when the premium was determined.[4]

3 The reference periods are less than or equal to 5 years; 5-10 years; 10-15 years; and greater than 15 years.
4 The initial age groups are under 70, 70-79, 80-89, and 90 and over.

How are the interest rates determined?

Interest rates are based on the book yield of prescribed portfolios, which are combinations of Treasury bonds and bonds of various credit qualities. Each reference period bucket is composed of assets of different maturity.

The VM-22 valuation rate for non-jumbo contracts equals the sum of four components:

1. Risk-Free Rate
2. + Investment Spreads
3. – Default Cost
4. – Spread Deduction

The reference rate is based on the average quarterly Treasury rates from the prior quarter. Investment spreads are JP Morgan and Bank of America bond spreads averaged over the quarter and defaults are based on moderately adverse defaults (CTE70) using Moody's data. For credit spreads and defaults, the prescribed credit quality in VM-22 is a mix of 5% Treasury securities, 15% AA, 40% A, 40% BBB. Finally, the spread deduction component is equal to a fixed 25 basis points, which provides an additional margin for moderately adverse conditions.

The VM-22 valuation rate for jumbo contracts equals the non-jumbo valuation rate, but adjusted to a daily basis. This adjusted rate is derived by determining the difference between Bank of America Merrill Lynch U.S. corporate effective yields on the day prior to contract issuance and prior quarter-end date.

Where can these interest rates be found?

The NAIC publishes applicable interest rates on its website. These can be found under the title of "VM-22 Current Tables."

The jumbo interest rates are published every business day; the quarterly rates for the non-jumbo contracts are published by the third business day of the quarter.

5 The applicable interest rates for NY can be found at Life Insurers - Maximum Reserve Valuation and Maximum Life Policy Nonforfeiture Interest Rates | Department of Financial Services (ny.gov).

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