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January 17, 2023

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

Dear Mr. Slutsker,

The American Academy of Actuaries¹ Annuity Reserves and Capital Work Group (ARCWG) is pleased to provide comments on the recent exposed draft of VM-22 entitled “VM-22 Subgroup Draft October 2022 Exposure_Clean” (Exposure).

In Section II, Subsection 2.E.2.a, the ARCWG proposes that the indicated company limit of \$0.5 billion be increased. First, small companies can exceed this limit without having issued very many contracts, due to the size of the deposits. In addition, those companies can demonstrate appropriateness of the reserves held and the assets backing those reserves through asset adequacy testing.

The ARCWG proposes a limit of \$1.0 billion rather than \$0.5 billion. The Life Principle Based Reserves (PBR) Exemption is \$300 million of exemption premiums. Generally, it would take small companies a number of years, if ever, to exceed the life exemption premium threshold. The Life PBR Exemption aims to satisfy the balance between not creating an undue burden on small companies, while requiring companies with a meaningful block of life business to hold PBR. A similar limit e.g., \$0.5 billion, would result in companies with potentially a few years of sales to be required to calculate PBR reserves, as annuity deposits are generally much larger for small companies compared to life insurance premiums. A higher limit, such as \$1 billion, would strike a reasonable balance between company burden and risk. It would recognize the interest rate sensitivity of much of the business covered under VM-22 and the benefit of right-sizing reserves by subjecting those blocks to stochastic reserve (SR) calculations while also limiting PBR impact on companies.

Regardless of what exemption limit is ultimately chosen, the ARCWG proposes that the limit be coordinated with and higher than the limit determined in Section 7.A.1.d.v (as exposed by the

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.

NAIC, titled Academy SPIA Exclusion Proposal 2022 11 30 v2.pdf). 7.A.1.d.v represents a subset of products covered by VM-22 so the broader exemption should have a higher limit.

In Section II, Subsection 2.E.3, the referenced line items appear to refer to amounts net of reinsurance. The ARCWG proposes that the exemption limits in both Section II, Subsection 2.E.2.a, and Section 7.A.1.d.v be based on amounts gross of reinsurance. It is possible that a carrier could have material liability when viewed on a gross of reinsurance basis and an immaterial liability, ignoring counterparty risk, on a net of reinsurance basis. The ARCWG proposes the following change, noted in *italics*.

3. Exemption Reserves are *the gross of reinsurance equivalent amounts to the items listed below:*

In response to the drafting note in Section II, Subsection 2.E.4.a, the ARCWG does not have a consensus opinion on whether guaranteed living benefits (GLBs) should be eligible or ineligible for the Annuity PBR Exemption. In general, the ARCWG continues to support exemptions when prudent. With that in mind, the ARCWG put together a support list for and against eligibility for the Valuation Manual (VM)-22 (A) Subgroup (VM-22 Subgroup) to consider:

Arguments against allowing GLBs to be eligible for the Annuity PBR Exemption:

- Companies need to understand the risk and model it, even if they reinsure just the GLB.
- Consistency with VM-20 – ULSG is not eligible for the exemption unless it meets the definition of a non-material secondary guarantee.
- While GLBs may not be a material portion of the business, many immaterial exemptions across the VM can add up to material risk.

Arguments for allowing GLBs to be eligible for the Annuity PBR Exemption:

- The ARCWG expects that the AG-33 reserve held after electing the exemption to exceed a stochastic reserve (SR), so only companies with small blocks of contracts with GLBs should consider electing to be exempt; that is, defaulting back to AG-33 should not be an incentive to pursue exemption.
- In a principle-based framework, the qualified actuary's judgment should be relied upon with respect to risk and materiality. Appropriate documentation of the actuary's decisions would be included in the VM-31 report.
- Small blocks of GLBs requiring a SR, when the majority of a company's business is eligible for exemption, may necessitate allocating disproportionate resources for immaterial risk.

Should it be decided that GLBs are not eligible for the Annuity PBR exemption, the ARCWG proposes that language is included in the VM to permit case-by-case exemptions to be granted by the domiciliary commissioner. The language should be included in a VM section that encompasses all blocks of business rather than be part of VM-22 specifically, because requests

for exemption by VM section could potentially lead to multiple requests for small exceptions that, in aggregate, constitute material risk.

In response to the Drafting Note in Section II, Subsection 2.F, the ARCWG proposes that “generally” be replaced with “shall” in order to be consistent with the lead-in paragraph. The ARCWG believes “shall” will remove ambiguity.

In response to the Drafting Note in Section 3.F.a.vi., the ARCWG believes that it should be left to the actuary to determine whether to categorize guaranteed living benefit contracts with depleted fund values as either belonging to the payout or accumulation reserving category. Justification for the choice should be included in the VM-31 report.

In response to the Drafting Note in Section 3.I.1, the ARCWG agrees with replacing “periodically” with “at least every 3 years” in Section 3.I.1. This will remove ambiguity around “periodically”. The ARCWG also supports making this change in conjunction with adoption of a similar APF for VM-20/VM-21.

In Section 4.A.4.b.i.c, the ARCWG proposes that X and Y be determined subsequent to the VM-22 field test. Modeling will help identify the appropriate level for the Index Credit Hedge Margin.

In Section 4.A.6, the ARCWG proposes that “no obligations” be replaced with “no material amount of business.” This would make this language consistent with the language in VM-31 Section 3.D.2.f.

In Section 4.B.1, the final paragraph requires adjusting the cash surrender value floor on the valuation date by any applicable market value adjustment if the related assets are held at market value. It could be that some assets are held at market value and others at book value when assets are held in the general account. The ARCWG proposes adding language that indicates that if an immaterial (x% or less of the total market value of all assets, excluding derivatives used solely to support index credits, where x is either prescribed by regulators or justified by the Qualified Actuary) amount of assets is held at market value, no market value adjustment shall be applied to the cash surrender value.

The ARCWG also considered more advanced methods. The ARCWG felt that a more complicated approach may not yield a better answer and it is also anticipated that situations where material amounts of assets are held at market value and others at book value would be exceptions rather than the norm.

In Section 10.C, sensitivity testing is required for Account Transfers. Section 10.D.2.a indicates that the impact of account transfers “might be ignored.” These two sections appear inconsistent with each other and are likely to cause confusion for the reader. The ARCWG suggests either eliminating Account Transfers in Section 10.C or changing the language in Section 10.D.2.a.

In the paragraph following the bulleted sensitivities in Section 10.C, the ARCWG proposes that “more complex” be replaced with “appropriately reflective of the risk of adverse deviations from the baseline assumption”.

Redlined changes were made to the Exposure and are entitled VM-22 Subgroup Draft October 2022 Exposure_Clean ARCWG Comments Redline.docx. The document accompanies this comment letter, with changes noted as appropriate.

If you have any questions or would like further dialogue on the above topics, please contact Amanda Barry-Moilanen, life policy analyst, at barrymoilanen@actuary.org.

Sincerely,
Chris Conrad
Chair, Annuity Reserves and Capital Work Group
American Academy of Actuaries

CC: Scott O’Neal,
NAIC