

## **Life and Health Actuarial Task Force**

### **Amendment Proposal Form\***

1. Identify yourself, your affiliation and a very brief description (title) of the issue.

Dave Neve, chairperson of the American Academy of Actuaries Life Reserves Work Group.

Treatment of Due Premiums in VM-20 reserve calculation

2. Identify the document, including the date if the document is “released for comment,” and the location in the document where the amendment is proposed:

VM-20: Requirements for Principle-based Reserves for Life Products, Draft dated 12/2/2012, Sections 2, 6A and 7B.

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on “track changes” in Word®) version of the verbiage. (You may do this through an attachment.)

See attached document.

4. State the reason for the proposed amendment? (You may do this through an attachment.)

The current draft of VM-20 is silent on the treatment of due premiums. This proposal treats due premiums similar to deferred premiums when determining the adjustment for DPA in section 2, and requires that due premiums be included in the expected future cash flows when calculating the Deterministic Reserve (DR) and Stochastic Reserve (SR). Since this approach reduces the resulting DR and SR amounts compared to the reserve amounts that would be calculated had there been no due premiums in the cash flows, it is appropriate to include due premiums along with deferred premiums when making the comparison of the DR and SR to the NPR.

Please note the following when reviewing this proposal:

- The total assets of the company do not change when due premiums arise from non-payment of premiums. Rather than getting cash, the company sets up a due premium asset.
- Since the due premiums are expected to be received in cash after the valuation date, the DR and SR will be reduced compared to what the DR and SR would be without any due premiums. This is because only cash premiums are treated as revenue in the DR and SR calculation (i.e., the change in due premiums is not treated as revenue in the DR and SR calculation).
- The combination of the first two bullet points produce a net increase in surplus when due premiums arise. But there should be a neutral impact on surplus whether the premium is paid the day before the valuation date or the day after the valuation date. This is why this proposal is needed, since it adds the due premium to the DR and SR amount before the comparison is made to the NPR when determining the minimum reserve.

\* This form is not intended for minor corrections, such as formatting, grammar, cross-references or spelling. Those types of changes do not require action by the entire group and may be submitted via letter or email to the NAIC staff support person for the NAIC group where the document originated.

**NAIC Staff Comments:**

Dates: Received	Reviewed by Staff	Distributed	Considered
<b>Notes:</b>			

**Section 2. Minimum Reserve**

- A. All policies subject to these requirements shall be included in one of the groups defined by paragraphs 1, 2 or 3. The company may elect to exclude one or more groups of policies from the stochastic reserve calculation and the deterministic reserve calculation if the exclusion tests determined pursuant to section 6 are passed. The minimum reserve equals the sum of:
1. For the group of policies that pass both the stochastic exclusion and the deterministic exclusion test: the aggregate net premium reserve for those policies.
  2. For the group of policies that pass the stochastic exclusion test but do not pass the deterministic exclusion test: the aggregate net premium reserve plus the excess, if any, of the deterministic reserve determined pursuant to Section 4 over the quantity (A-B) where A = the aggregate net premium reserve for those policies, reduced by and B = any deferred premium asset due and deferred premium asset held on account of those policies.
  3. For the group of policies that fail the stochastic exclusion test, and for the group of policies not subject to the exclusion tests: the aggregate net premium reserve plus the excess, if any, of the greater of the deterministic reserve determined pursuant to Section 4 and the stochastic reserve determined pursuant to Section 5 over the quantity (A-B) where A = the aggregate net premium reserve for those policies, reduced by and B = any deferred premium asset due and deferred premium asset held on account of those policies.

**Section 6. Stochastic and Deterministic Exclusion Tests**

- A. Stochastic Exclusion Test
3. Stochastic Exclusion Demonstration Test
  - b. The company may use one of the following or another method acceptable to the commissioner to demonstrate compliance with subsection 6.A.3.a:
    - i. Demonstrate that the greater of [the quantity A and the quantity B] is greater than the stochastic reserve calculated on a standalone basis, where:

A = the deterministic reserve, and  
B = the net premium reserve, less any associated ~~deferred premium asset due and deferred premium asset~~, ~~is greater than the stochastic reserve calculated on a standalone basis.~~

- ii. Demonstrate that the greater of [the quantity A and the quantity B] is greater than the scenario reserve that results from each of a sufficient number of adverse deterministic scenarios, where:

A = the deterministic reserve, and  
B = the net premium reserve, less any associated ~~deferred premium asset due and deferred premium asset~~, ~~is greater than the scenario reserve that results from each of a sufficient number of adverse deterministic scenarios.~~

- iii. Demonstrate that the greater of [the quantity A and the quantity B] is greater than the stochastic reserve calculated on a standalone basis, but using a representative sample of policies in the stochastic reserve calculations, where:

A = the deterministic reserve, and  
B = the net premium reserve, less any associated ~~deferred premium asset due and deferred premium asset~~, ~~is greater~~

~~than the stochastic reserve calculated on a standalone basis, but using a representative sample of policies in the stochastic reserve calculations.~~

- iv. Demonstrate that any risk characteristics that would otherwise cause the stochastic reserve calculated on a standalone basis to exceed greater of the deterministic reserve and the net premium reserve, less any associated ~~deferred premium asset due and deferred premium asset~~, are not present or have been substantially eliminated through actions such as hedging, investment strategy, reinsurance, or passing the risk on to the policyholder by contract provision.

## Section 7. Cash Flow Models

### B. General Description of Cash Flow Projections

1. For the deterministic reserve and for each scenario for the stochastic reserve, the company shall project cash flows ignoring federal income taxes and reflecting the dynamics of the expected cash flows for the entire model segment. The company shall reflect the effect of all material product features, both guaranteed and non-guaranteed. The company shall project cash flows including the following:
  - a. Revenues received by the company including gross premiums received from the policyholder (including any due premiums as of the projected start date).

**Guidance Note:** to be consistent with quantity B defined in Section 2.A.2 and 3, and quantity B defined in Section 6.A.3.b., all due premiums as of the projection start date are assumed to be collected after the projection start date, but the company needs to determine an assumption as to the timing of when the due premiums will be received.

### D. Starting Assets

1. For each model segment, the company shall select starting assets such that the aggregate annual statement value of the assets at the projection start date equals the estimated value of the minimum reserve allocated to the policies in the appropriate model segment subject to the following:
  - a. **Starting asset values shall include the relevant balance of any due, accrued or unearned investment income**  
The aggregate annual statement value of the assets at the projection start date shall be composed of:
    - i. cash and invested assets
    - ii. due, accrued or unearned investment income on cash and invested assets
    - iii. the relevant due premium asset.