



AMERICAN ACADEMY *of* ACTUARIES

June 5, 2014

Blaine Shepherd
Chair, Separate Account Risk (E) Working Group
National Association of Insurance Commissioners

Dear Blaine:

The Separate Account Products Work Group (SAWG) of the American Academy of Actuaries¹ Life Practice Council appreciates the opportunity to provide comments on the *Revised Recommendations* document exposed for comment on May 7, 2014 by the Separate Account Risk (E) Working Group (NAIC Working Group).

The SAWG appreciates the complexity of this issue, and the difficult task before the NAIC of sorting out concerns and efficiently developing solutions. We therefore suggest that the NAIC Working Group first agree on the core principles (Item 1) before determining where changes are needed or determining how those changes might be implemented (currently found in parts of both Item 1 and Item 2). Our comments reflect this suggestion.

Attached is the exposure document with our suggested changes in track changes format. Our reasoning behind the suggested changes follows. Some of the suggested changes and reasoning are repeated from prior letters.

Comments on Item 1

Title

The SAWG suggests replacing the term “Non-Variable Products” with the term “Non-Unitized Separate Account Products” since we believe it more properly describes the products targeted by the NAIC Working Group. The definition of variable products is not universal, and, in fact, Model #255 states that modified guaranteed annuities are variable annuities, which would suggest that they are not subject to the exposure, when the NAIC Working Group has suggested they are.

¹ The American Academy of Actuaries is an 18,000-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.

Item 1.b

- The SAWG suggests adding a footnote to the first sentence in order to point out that the principles may conflict with regulation already in place.
- We suggest deleting the parenthetical expression that follows the first sentence in this paragraph, except for the sentence, “Under this proposal, it would be further clarified that seed money, risk-charges, spread and guarantees would not be insulated.” We believe the parenthetical expression is unnecessary, and may even serve to take away from a point that is already clear.
- We suggest deleting the last sentence, “Under this proposal, funds eligible for insulation would include funds contributed by customers that are transferred from the General Account to the Separate Account as a result of timing of the investment of customer premium.” We do not believe this statement belongs with the statement of principles, but, if it remains here or ends up in another part of the document it would need to be explained further to ensure it is consistent with the principles and not an exception to the principles. If it intends to allow interest credited in the general account on a BOLI/COLI product to be considered as insulated, we are concerned that this opens the door to a company being able to manage the investment of assets in some combination of the separate account and the general account to the benefit of the BOLI/COLI client, and potentially to the disadvantage of the general account customers.

Item 1.c

The SAWG suggests that Item 1.c. be limited to an edited version of the first sentence that would then read, “Every product should be filed with an opinion provided by a qualified actuary that the general account is adequately compensated for its provision of guarantees related to the contract liabilities for newly issued business.”

The other sentences in the paragraph provide details on how this principle could be implemented and the remedies that apply when a company cannot comply. We are concerned that the details and remedies cited may not consider all the issues involved and may therefore require additional discussion. Specific comments on the edits/deletions follow:

- “Qualified actuary” needs to be footnoted in the first sentence (i.e., the first time it is mentioned), whether or not the other sentences are deleted.
- Limit the use of the term “pricing” (implies rate regulation) and focus instead on the general account being adequately compensated by the separate account for the product guarantees.
- “Certifying” is not the appropriate term since the actuary’s opinion depends upon the assumptions that are used and even the most well-thought-out assumptions may not, in the end, duplicate actual results. The sentence works just as well without the word, “certifying.”

- We suggest deleting the text on the methodology for handling the opinion after the initial rate filing and the remedy for not being able to give such an opinion because this is a detail that may not fit all situations. Instead, we have added a general statement noting that these issues will need to be addressed.

Item 1.d

The SAWG suggests adding, “where required by regulation” to make the sentence more accurate.

Comments on Item 2

Title

The SAWG suggests clarifying the title to state that the intention of the NAIC Working Group would be to consider updates to these documents only to the extent that they would affect new issues.

Item 2.a

- The SAWG remains concerned that adding additional rules for insulation to Model #255 will be difficult to implement, without changing the framework of Model #255. As we stated in the SAWG’s May 5 letter, insulating assets in the aggregate does not recognize the individual circumstances applicable to each modified guaranteed annuity (MGA) contract, which may have a contract-specific guarantee. We continue to believe that the NAIC Working Group should decide first whether it wants to allow insulation on such products.
- We suggest deleting the phrase, “unless for contracts sold prior to the adoption of the change to Model #255.” We are not sure what this is intended to mean and it is a confusing phrase in a sentence that is already too long. If it means that any changes would only apply to new issues, that point is better made up front.
- We suggest deleting the phrase, “notwithstanding the provisions of applicable law that specifies that the extent and scope of insulation shall be as provided under the applicable separate account provision.” We are not sure what this adds that isn’t already stated.
- We suggest deleting the second to last sentence and inserting two new sentences that read, “Revisions should be considered that would specify the conditions or circumstances, if any, under which such transferred assets could be insulated assets (e.g., the premium is initially put into the general account during the free look period, and then moved to the separate account). This should include an examination of how premiums, benefits, charges, and other transfers are moved between the general account and separate accounts for these products.” We would then suggest moving the following sentence to the end of the paragraph: “Non-insulated transferred assets will have the same priority as general account assets in the event of an insolvency.” Note that the suggested rewrite of this paragraph also deletes the phrase, “unless specifically insulated under the applicable

separate account contracts” since we believe this statement is inconsistent with the principles.

Item 2.b

The SAWG added this section because, with potentially thousands of contracts backed by one separate account, it would be necessary to determine the separate account “earnings” allocated to each contract. Will regulators set any guidelines for such allocation, and will this process or its result need to be communicated to the contractholder? Would companies be required to allocate earnings on an ongoing basis or only in the event of an insolvency? Also, what information will be required in the contact form, if any, to explain this benefit?

Item 2.c

- Model #255 does not currently require an actuarial opinion on the adequacy of compensation to the general account to provide for the guarantees, when assets are insulated. The SAWG notes that in order to be consistent with the principles, a framework for such an opinion would need to be added.
- In 2009, adding requirements for such an opinion to SSAP #56 was considered and rejected. The SAWG agrees with that decision, since the requirement for an opinion is not an accounting issue. However, if there is a decision to add a requirement for an opinion to either model #255 or SSAP #56, then it is important that the opinion come from a qualified actuary and not, “the appointed actuary for the general account” as was considered in the 2009 exposure draft. As the Life Financial Soundness/Risk Management Committee of the Academy pointed out in its April 30, 2009 letter commenting on the 2009 proposed changes to SSAP #56, the appointed actuary may not be the appropriate person to provide this part of the opinion. From an actuarial perspective, opining on risk charges may require a different skill set than opining on the adequacy of reserves.

Comments on Item 3

Item 3.a

We assume the reference to book value/non-insulated is for completeness; otherwise we do not understand the purpose for its inclusion. Also, is this expansion of scope meant to include both group and individual? And both life and annuity? Or only Group Annuity? That should be made clearer.

Item 3.c

Model #200 already includes a section requiring an opinion on the adequacy of risk charges for guarantees, so we are not sure what it means to state, “Model #200 should also be reviewed to ensure adequate compensation to the general account for guarantees.” The SAWG’s particular concern is that the section of the actuarial opinion required on risk charges (section 10.E.(5)(a) of Model #200) is required to be rendered by the appointed actuary, or another qualified actuary designated by the appointed actuary. As the Life Financial Soundness/Risk Management Committee of the Academy pointed out in its April 30, 2009 letter commenting on changes

proposed to SSAP #56 mentioned above, the appointed actuary may not be the appropriate person to provide this part of the opinion.

The SAWG will continue to follow further developments on this issue and offer additional comments as appropriate. In the meantime, if you have any questions please contact John Meetz, the Academy's life policy analyst (202-223-8196; meetz@actuary.org).

Sincerely,

Cande Olsen, FSA, MAAA
Chairperson, Separate Account Products Work Group
American Academy of Actuaries

SEPARATE ACCOUNT RISK (E) WORKING GROUP

May 7, 2014

Exposure – Revised Recommendations

Comments Due June 6, 2014

On May 7, 2014, the Separate Account Risk (E) Working Group exposed three revised recommendations for separate account products. Comments are requested by June 6, 2014.

(These recommendations were initially exposed November 2013, with comment letters considered on March 24, 2014. The following exposed recommendations reflect revisions discussed on March 24 and presented to the Working Group on May 7.)

1. Incorporate Suggested Principles for Insulating Separate Account Assets for ~~Non-Variable~~ for Non-Unitized Separate Account Products

- a. For assets to be considered insulated, the contract must contain provisions to that effect.
- b. Insulated assets should derive only from funds contributed by customers, plus earnings thereon, less any withdrawals and fees.¹ ~~(The suggested principles recommend that insulated assets should derive only from funds contributed by customers, plus earnings thereon, less any withdrawals and fees. During the June 5 call, the proposal was clarified as intending to mirror existing New York limitations in which insulation is limited to the assets purchased by policyholder funds, and not the account value of contributions. If assets deteriorate, then the insulated value would be the reduced asset value and not the original amount contributed to acquire the assets. Under this proposal, it would be further clarified that seed money, risk-charges, spread and guarantees would not be insulated.) Under this proposal, funds eligible for insulation would include funds contributed by customers that are transferred from the General Account to the Separate Account as a result of timing of the investment of customer premium.~~
- c. Every product should be ~~initially~~ filed with an opinion provided by a qualified actuary² ~~as to the sufficiency of the pricing certifying~~ that the general account is adequately compensated for its provision of guarantees related to the contract liabilities for newly issued business. ~~Subsequent to initial filing, for all products subject to these principles, an updated opinion by a qualified actuary³ should be annually completed with documentation in a new general interrogatory/disclosure that for each product currently offered for sale the general account will continue to be adequately compensated for its provision of guarantees with respect to future new issues of that product. If the actuary indicates that the pricing of the product no longer allows for adequate compensation of the general account, the product with the inadequate pricing should be identified, and the company must discontinue new sales of the contract until the pricing is adequate and an updated opinion is filed. Details such as guidance for the required opinions and remedies for situations where a clean opinion cannot be provided will need to be developed.~~
- d. For book value separate account assets, all reserves, including investment reserves should be calculated on the same basis as if they were issued through the general account, adjusted in accordance with any

¹ Implementation of these principles may conflict with some model laws/regulations and/or state laws/regulations already in place. For example, the implementation of such principles will require a redefinition in Model Reg 255 of what funds may be insulated in MGA contracts. The wording of this principle is not consistent with the MGAs currently sold, which are designed to comply with Model Reg 255.

² A qualified actuary is an actuary who meets the American Academy of Actuaries' U.S. qualification standards.

³ A qualified actuary is an actuary who meets the American Academy of Actuaries' U.S. qualification standards.

unique contract attributes. For fair value⁴ separate accounts, reserves should be calculated to correctly reflect the nature of the liabilities and, where required by regulation, the yield on assets.

- e. Any reserves in excess of the amount held as insulated in a separate account, determined on the basis of book or fair value, as the case may be, must be held as a non-insulated amount, or in the general account, or in a non-insulated supplemental separate account.

2. Review and Consider ~~Updating~~Making Revisions to SSAP No. 56 and Model #255 that would apply to new issues only

- a. Guidance in Model #255 (*Modified Guaranteed Annuity Model Regulation*) and SSAP No. 56—*Separate Accounts* requires a transfer of assets from the general account to the separate account so that the separate account maintains assets at least equal to the required reserves in the separate account. It is deemed likely that this guidance would be interpreted such that the transferred assets would be considered insulated, ~~unless for contracts sold prior to the adoption of the change to Model #255~~, if the separate account products are insulated under the applicable contracts, ~~notwithstanding the provisions of applicable law that specifies that the extent and scope of insulation shall be as provided under the applicable separate account contracts~~. Revisions should be considered that would specify the conditions or circumstances, if any, under which such transferred assets could be insulated assets (e.g., the premium is initially put into the general account during the free look period, and then moved to the separate account). This should include an examination of how premiums, benefits, charges, and other transfers are moved between the general account and separate accounts for these products. Recommended revisions would clarify that such transferred assets are non-insulated assets, and classify transferred assets in the same priority as general account assets in the event of an insolvency, unless specifically insulated under the applicable separate account contracts. Revisions allowing assets/reserves to be retained in the general account for the separate account, rather than requiring transfer to the separate account, as well as revisions to allow a transfer of assets/reserves from the general account to a specific non-insulated supplemental separate account should also be considered. Non-insulated transferred assets will have the same priority as general account assets in the event of an insolvency
- b. Rules will need to be developed for determining and communicating in the contract form the insulated amount for each contractholder. This will include how allocation of earnings will be accomplished and whether such allocation needs to be done on an ongoing basis or only in the event of an insolvency. Also, what kind of detail will be needed in the contract form to explain this benefit.
- c. Model #255 should also be reviewed to ensure adequate compensation to the general account for guarantees, when assets are insulated. Revisions may need to be made to SSAP #56 on the adequate compensation issue to support changes made to other models (like #255 or #200).

⁴ Fair Value is defined in SSAP No. 100—*Fair Value Measurements* (SSAP No. 100) as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

3. Review and Consider Updating Revisions to Model #200

- a. Guidance in Model #200 (*Separate Accounts Funding Guaranteed Minimum Benefits for Group Contracts Model Regulation*) already prescribes insulation limitations for contract holder contributions and earnings thereon. However, consideration is recommended to ensure all of the following product categories are addressed with Model #200: 1) market value / insulated, 2) book-value / non-insulated, and 3) book value / insulated.
- b. For separate accounting products measured at book value (insulated or non-insulated) captured in Model #200, analysis and consideration should occur to determine whether asset diversification and related requirements should apply.
- c. Revisions to Model #200 should also be reviewed to ensure adequate compensation to the general account for guarantees, when assets are insulated.
- d. The limited state adoption of Model #200 (and #255) may impact the revisions being considered as a formal process to open and revise the model will require state support to bring the model to legislation. Consideration may occur on whether these models should be deleted and incorporated in a different structure.

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