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 Letters of Credit and other similar assets in 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 7B and 7D.

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 how Letters of Credit and other similar assets are treated in the reserve calculations. This proposal treats LOCs similar to how many actuaries handle LOCs in cash flow testing. It includes LOCs in starting assets, and includes LOC fees as an expense in projected cash flows.

* 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
Notes:			

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.

   b. Amounts charged to account values on general accounts business and use those amounts to determine any effects on future policy benefits, and not as revenue.

      Guidance Note: Amounts charged to account values on general accounts business examples include cost of insurance and expense charges.

   c. All material benefits paid to policyholders, including but not limited to death claims, surrender benefits, and withdrawal benefits, reflecting the impact of all material guarantees.

   d. Net cash flows between the general account and separate account for variable products.

      Guidance Note: Cash flows going out from the general account to the separate account increase the reserve, and cash flows coming in to the general account from the separate account decrease the reserve. Examples include allocation of net premiums to the separate account, policyholder-initiated transfers between fixed and variable investment options, transfers of separate account values to pay death or withdrawal benefits, and amounts charged to separate account values for cost of insurance, expense, etc.

   e. Insurance company expenses (including overhead expenses), commissions, fund expenses, contractual fees and charges, and taxes (excluding federal income taxes and expenses paid to provide fraternal benefits in lieu of federal income taxes).

   f. Revenue sharing income received by the company (net of applicable expenses) and other applicable revenue and fees associated with the policies and adjusting the revenue to reflect the uncertainty of revenue sharing income that is not guaranteed.

   g. Net cash flows associated with any reinsurance as described in Section 8.

   h. Cash flows from derivative liability and derivative asset programs, as described in Section 7.L.

   i. Fees paid on Letters of Credit or other similar vehicles as as long as they are treated as admitted assets on the balance sheet of the company.

   j~~i~~. Cash receipts or disbursements associated with investment income, realized capital gains and losses, principal repayments, asset default costs, investment expenses, asset prepayments, and asset sales. Cash flows related to policy loans are handled in the reserve calculation in a manner similar to cash flows to and from separate accounts.

      Guidance Note: Since the projection of cash flows reflect premium mode directly, deferred premiums are zero under this approach.

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.

    b. For an asset portfolio that supports both policies that are subject and not subject to these requirements, the company shall determine an equitable method to apportion the total amount of starting assets between the subject and non-subject policies.

    c. If for all model segments combined, the aggregate annual statement value of starting assets is less than 98% or greater than the larger of NPR or 102% of the final aggregate modeled (whether stochastic or deterministic) reserve, the company shall provide documentation in the PBR Actuarial Report that provides reasonable assurance that the aggregate modeled reserve is not materially understated as a result of the estimate of the amount of starting assets.

2. The company shall select starting assets for each model segment that consists of the following:

    a. All separate account assets supporting the policies.

    b. All policy loans supporting the policies that are explicitly modeled under Section 7.E.

    c. All derivative instruments held at the projection start date that are part of a derivative program and can be appropriately allocated to the model segment.

    d. Letters of Credit and other similar asset vehicles as long as they are treated as an admitted asset on the balance sheet of the company.