AMERICAN ACADEMY *of* ACTUARIES

May 15, 2014

Mr. Michael W. Boerner
Chair, Life Actuarial Task Force
National Association of insurance Commissioners

Re: ACLI's VM-20 Small Company Exemption Proposal

Dear Mike:

The Life Practice Council (LPC) of the American Academy of Actuaries[1] has reviewed the Amendment Proposal Form (APF) as exposed by the Life Actuarial Task Force on 3/27/14 and appreciates the opportunity to provide you with the comments noted below.

The LPC's long-held view, indeed from the outset of developing a PBR regime with the NAIC, is that any exclusion or exemption from a principle-based life reserving regime, now embodied in the NAIC's VM-20 requirements, should be based on the risk factors to which a company is exposed, not on factors such as the size of the company. However, while the LPC does not support an exemption-based on company size, we understand the concerns articulated by small companies with respect to the additional work/effort that VM-20 could require if a company does not issue products with significant risks. To most appropriately address such concerns, the LPC suggests LATF consider a combination of changes to VM-20 that would effectively produce, when implemented, a result that is consistent with the intended effect, as we interpret it, of the ACLI's APF but retains the more effective goal of risk-based exemptions. We believe the changes described below satisfy the objectives of the APF for small companies, and would also improve VM-20 for <u>all</u> companies.

1. Define the term "non-material secondary guarantee," as the ACLI proposes (Section 1.C., New Definition), but with several clarifications. These clarifications are needed for the part of the definition where the present values of premium streams are determined.

    a. "Net premiums" should be "net *level* premiums."

    b. The document should clarify what is meant by the term "preferred tables" in the context of the valuation basic table (VBT) relative risk tables. The relative risk tables that are considered preferred require identification.

    c. The "maximum valuation interest rate" should be more explicitly identified. The current ambiguous reference could refer to rates in Appendix A or those required by Section 3 (NPR calculations) of VM-20.

[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.

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d. Replace the term "NLG" (no lapse guarantee) with "SG" (secondary guarantee) since the term "NLG" is not defined.

e. In the first bullet point of the definition in the APF, drop the phrase "for each policy" after "The duration of the SG".

2. Modify the Stochastic Exclusion Test language (Section 6.A.1.a. iii. of VM-20) such that the actuarial certification option is *permitted* for any UL policy that meets the non-material secondary guarantee definition. Proposed wording for the first sentence of Section 6.A.1.a.iii: "For groups of policies other than 1) variable life or 2) universal life with a secondary guarantee that are not comprised exclusively of non-material guarantees, in the first year and at least every third calendar year thereafter the company provides a certification by a qualified actuary . . . ." The actuarial certification in this situation would include a demonstration of the non-materiality of the secondary guarantee.

3. Consistent with ACLI's APF, modify the language of the Deterministic Exclusion Test (Section 6.B.1 of VM-20) such that it may be applied to universal life (UL) policies with non-material secondary guarantees. Universal Life with Secondary Guarantee (ULSG) policies comprised exclusively of non-material secondary guarantee provisions will then be allowed to use the deterministic exclusion test, which should not be burdensome since the test only requires the stream of NPR net premiums and the stream of guarantee premiums from the policy – values necessary for purposes other than the exclusion test.

The LPC recommends eliminating the risk-based capital RBC criteria in the ACLI APF since the RBC formula was not designed to be a measure of capital adequacy but to be a tool to identify weakly capitalized companies. We believe the definition of a "non-material secondary guarantee" is an adequate risk measure for the purpose of allowing the use of the exclusion tests in VM-20. This could then result in these products being excluded from the VM-20 modeling requirements and, thus, a risk measure based on RBC is not needed.

In summary, the recommendations take the approach of expanding and enhancing the current VM-20 exclusion tests rather than introducing a new exclusion test that is based in part on company size and RBC levels.

In addition to the small company APF, there are two additional related APFs from the ACLI:

- The concept of using a company's cash flow testing assumptions for the adjusted deterministic reserve in the stochastic exclusion ratio test (SERT) instead of using anticipated experience assumptions currently required by VM-20 and

- The concept of revising the SERT threshold from 4.5% to 6.0%

Regarding the first item, the LPC supports this modification because it makes the SERT more practical for all companies. The initial concept of the SERT proposed by the Academy was based on cash flow testing models and assumptions because the test could be accomplished by using available models and assumptions.

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Regarding the second item, the LPC suggests that whatever threshold is adopted, the NAIC monitor the threshold going forward and revise as appropriate.

We appreciate the opportunity to comment on this APF and are available to discuss any questions arising from our suggestions.

Sincerely,

Mary O. Bahna-Nolan

Mary Bahna-Nolan, FSA, MAAA,
Vice-President,
Life Practice Council
American Academy of Actuaries

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