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AMERICAN ACADEMY *of* ACTUARIES

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April 11, 2014

Commissioner Julie Mix McPeak and Superintendent Joseph Torti III  
Co-Chairs, NAIC Principle-based Reserving Implementation (EX) Task Force  
National Association of Insurance Commissioners

Dear Commissioner McPeak and Superintendent Torti:

The American Academy of Actuaries<sup>1</sup> Principle-Based Reserve Strategy Subgroup (PBRSS) of the Life Practice Council provided [comments](#) on March 21, 2014 on the exposed February 17, 2014 *Report of Rector & Associates, Inc. to the Principle-Based Reserving Implementation (EX) Task Force (Report)*, which is attached.

Since our previous comments, we have received several questions and are therefore clarifying our suggestion to eliminate the net premium reserve (NPR) component of VM-20. In the Report, adjustments to the NPR calculation were suggested as part of the Report's recommendation to use a slightly modified version of VM-20 for purposes of determining the Primary Asset Level. Our specific comment was, "We suggest eliminating the net premium reserve entirely for this purpose, since the purposes for including a formula-based net premium reserve floor in the Valuation Manual do not apply to the aspects of captive arrangements covered in the Report."

While the Academy was not involved in either its development or testing, we understand that the NPR is a formula-based reserve with fixed industry level assumptions established at policy issue that was developed with the intention of being consistent with the existing U.S. Internal Revenue Code, thereby potentially serving as a basis for the deductible tax reserve. It is also the expectation that the NPR would reasonably approximate the aggregate deterministic reserve for a diverse book of business issued over many years, although with NPR assumptions established at issue and deterministic reserves potentially updated at each valuation it is not assured that this will occur in all circumstances. Since the initial development of the NPR, we understand that it may also be perceived as a floor in certain situations. For instance, we realize that for the early durations of some products, the NPR might exceed the deterministic reserve, but at those durations the reserves are of such low amounts that the difference would be insignificant.

In a number of important ways the NPR is not principle-based, including that 1) it does not reflect specific company experience; 2) it is not sensitive to the specific product risks ceded through customized captive reinsurance arrangements; and 3) some of the reserve assumptions

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<sup>1</sup> 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.

are locked-in and are not adjusted as experience and economic conditions change. Applying the NPR to captive reinsurance transactions, which generally involve more narrowly defined product blocks issued over a limited period of time, could result in a Primary Asset Level that significantly misses the mark in either direction. This could result either in artificially increasing the Primary Asset Level required or causing significant calculation work and the devotion of resources to develop the reserve that is never used. For these reasons, the NPR component is not suitable and does not add value as a basis for the Primary Asset Level.

We believe that, in order to accomplish the purpose envisioned by the Report of backing the Primary Asset Level by hard assets, the Primary Asset Level should be an appropriately-determined risk-based reserve without the need for a prescriptive, formulaic floor. To that end, we recommend that, along with elimination of the NPR, the deterministic exclusion test also be eliminated, which will result in the deterministic reserve serving as the floor reserve. We also recommend that, at the current time, the Primary Asset Level be determined utilizing the current VM-20 reserve framework. As that framework is revised through the appropriate amendment process, it should continue to remain appropriate for the purposes intended by the Report.

We hope these additional comments are helpful. Please contact John Meetz, the Academy's life policy analyst ([meetz@actuary.org](mailto:meetz@actuary.org); 202-223-8196) if you have any questions.

Sincerely,

Cande Olsen, FSA, MAAA  
Chairperson  
Principle-Based Reserves Strategy Subgroup  
American Academy of Actuaries