



December 13, 2013

Mike Boerner, Chair
Life Actuarial (A) Task Force
National Association of Insurance Commissioners

Dear Mr. Boerner:

The American Academy of Actuaries¹ Life Financial Soundness / Risk Management Committee (LFS/RMC) appreciates the opportunity to respond to questions from the New York Insurance Department regarding the Academy's [proposal for treatment of due premiums](#). Our responses are in bold below:

1. Could you send a simple example. There is a lot of accounting going on regarding due premiums, and we want to make sure there's no double counting of assets & revenues. My initial observation is that the liability is initially overstated which results in an asset being created to offset this. However, if due premiums are included as revenues in VM-20 modeling, there would be additional offset, or a double counting. Please explain.

As the attached example demonstrates, the amount of due premiums has no impact on the final VM-20 reserve amount, nor on the final asset amount. The only impact is a shift in total assets between “invested assets” and the “due premium” asset.

2. Where is the due premium initially being calculated with respect to VM-20? Is it in the net premium reserve?

No. The due premium has no impact on the net premium reserve. However, it does impact the projected cash flows for the DR and SR calculation since the due premium will typically be included in future premiums. But as the attached example shows, the “due and deferred premium” adjustment to the DR (and SR) per the VM-20 requirements in section 2 results in the due premium amount having no impact on the final DR amount (assuming we incorporate the due premium amendment we are proposing; without this change to include due premiums along with deferred premiums, there would be an inappropriate “double counting” impact, since the DR would decrease as a result of due premiums, but there would also be a due premium on the asset page).

¹ The American Academy of Actuaries is a 17,500-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.

3. Regarding flexible premium products such as UL, how is a due premium determined. Is it formulaic or is there some judgment involved? Also, is the situation / accounting different with ULSG where there is a minimum premium or target premium?

There are no due premiums on flexible premiums products like UL. It only comes into play for fixed premium contracts like term and WL.

4. Would reinsurance have an impact on the due premium and the accounting, e.g., are there numbers netted out?

No. The due premium impact (as shown in the attached example) would be followed for both the pre-reinsurance reserve calculation and the post-reinsurance calculation. The only difference between the two calculations (in regard to the due premium impact) is that the post-reinsurance calculation would also bring into play the cash flows between the ceding company and the reinsurer.

Due Premium VM-20 Example

Assumptions

There are no "Due Premiums" on a flexible premium product like UL. This example assumes a term product

Annual premium = 2,000

Company passed the Stochastic Exclusion Test. No SR is calculated

Total invested assets = 70,000 (assumes no due premiums)

Deferred premium = 500

Scenario A: Assume there are no due premiums. All policies have paid their premiums as of the valuation date

Due premiums = 0

Total invested assets = 70,000

Projected cash premiums received in year 1 for DR calculation = 2,000

Net Premium Reserve = 50,000

Deterministic Reserve = 60,000

VM-20 reserve = greater of 1) NPR and 2) DR plus Due and Deferred Premium

= greater of 50,000 and (60,000 + 500 + 0) = 60,500

Balance Sheet

Assets

Invested Assets	70,000
Deferred premiums	500
Due Premiums	<u>0</u>
Total assets	70,500

Liabilities

VM-20 Reserve	60,500
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Surplus	10,000
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Scenario B: Assume due premiums of 100.

Due premiums = 100

Total invested assets = 70,000 - 100 = 69,900

Projected cash premiums received in year 1 for DR calculation = 2,000 + 100 = 2,100

Net Premium Reserve = 50,000 (no impact from due premiums)

Deterministic Reserve = 60,000 - 100 = 59,900. Reserve goes down since projected premiums have increased

VM-20 reserve = greater of 1) NPR and 2) DR plus Due and Deferred Premium

= greater of 50,000 and (59,900 + 500 + 100) = 60,500

Balance Sheet

Assets

Invested Assets	69,900
Deferred premiums	500
Due Premiums	100
Total assets	<u>70,500</u>

Liabilities

VM-20 Reserve	60,500
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Surplus 10,000

Assets, Reserves and surplus are unaffected by the amount of due premiums

Note: If the NPR is greater than the DR plus the D&D premium, then the VM-20 reserve would equal the NPR under both scenario A and B.

Assume that the NPR is 61,000. Then the PBR reserve is unaffected by the amount of due premium

Assets under both scenarios are still 70,500. Liabilities under both scenarios are 61,000.