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AMERICAN ACADEMY of ACTUARIES

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August 12, 2014

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

Dear Mike,

The American Academy of Actuaries<sup>1</sup> Principle-Based Reserves Strategy Subgroup (PBRSS) appreciates the opportunity to comment on the June 4, 2014 Rector & Associates report (June Report), specifically the Net Premium Reserve (NPR) component of Charge 3.

That charge, which was given to the Life Actuarial Task Force (LATF), states, “The Actuarial Method should consist of the NAIC Valuation Manual, VM-20, Requirements for Principle-Based Reserves for Life Products, modified to incorporate changes to mortality tables as developed by the American Academy of Actuaries and any other appropriate modifications determined by LATF, and should explicitly keep (in current or modified form) or eliminate the “net premium reserve” component of the current VM-20.”

As noted in our previous comment letters,<sup>2</sup> we do not believe that the NPR should be included in the VM-20 calculation used to determine the Primary Security Requirement referred to in the June Report for the following reasons:

- The rationale for including a formula-based NPR floor in the Valuation Manual does not apply to the aspects of captive arrangements covered in the June Report. As noted in our earlier letters, the backing of the Primary Security Level by prescribed asset types should be based on an appropriately-determined risk-based reserve without the need for a prescriptive, formulaic floor.
- While the PBRSS was not involved in either its development or testing, we understand the NPR to be a formula-based reserve that is intended to reasonably approximate the aggregate deterministic reserve for a broad group of policies issued over time.<sup>3</sup> Therefore, application of the NPR in the narrower context of captive reinsurance transactions, which generally involve more narrowly defined product blocks issued over a limited period of time, could significantly miss the intended approximation for some companies. This could result either

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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.

<sup>2</sup> See PBRSS letters dated [March 21](#), [April 11](#), [April 23](#), and [June 25](#).

<sup>3</sup> Please refer to our previous letters for more details on these points.

in a significant and artificial increase to the Primary Security Level (if the NPR for the company exceeds the deterministic reserve) or in additional calculation work and the devotion of resources to develop a reserve that is never used until VM-20 is operational (if the NPR for the company is below the deterministic reserve).

- The NPR 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. The NPR uses assumptions that have been calibrated to produce a reserve that approximates the deterministic reserve, and NPR assumptions are expected to be recalibrated over time as deterministic reserve assumptions change (based on our understanding of the intent of the Guidance Note in VM-20 Section 3.C.1 and the Drafting Note in VM-20 Section 3.C.2). The NPR is therefore not an independent floor reserve, since the NPR will be continually adjusted over time to approximate the deterministic reserve.

The PBRSS believes, for the reasons noted above, that the inclusion of the NPR as the basis for the determination of the Primary Security Level is not actuarially justified.

If LATF decides to recommend inclusion of the NPR, we expect assumptions for the existing NPR will need to be recalibrated to maintain consistency with the deterministic reserve once a new CSO mortality table becomes effective on December 31, 2014. This recalibration is needed to avoid overstatement of the NPR relative to the deterministic reserve (although the deterministic reserve will also be at a different level based on the underlying Valuation Basic Table). Therefore, use of the NPR is especially inappropriate in the first year of the new requirement (2015) since the recalibration would not be feasible until sometime later that year.

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

Sincerely,

Cande Olsen, MAAA, FSA  
Chairperson  
PBR Strategy Subgroup  
American Academy of Actuaries