AMERICAN ACADEMY of ACTUARIES

July 27, 2012

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

Dear Mr. Boerner:

In March 2011 the American Academy of Actuaries[1] Tax Work Group presented to the National Association of Insurance Commissioners (NAIC) Life Actuarial Task Force a report regarding Federal Tax Reserves and the Life PBR Elective Three-Year Statutory Transition Period. A recent case decided by the United States Court of Appeals for the Sixth Circuit, *American Financial Group v. United States,* 678 F.3d 422 (6th Cir. 2012) has caused the Tax Work Group to reexamine its report and present this supplemental report.

The Life PBR three-year transition period for statutory reserving would allow a life insurance company to elect not to implement Life PBR for up to three years from the effective date of PBR. This means that up to three years of issues could use the prior reserving methods for their entire duration. This three-year elective transition period does not require restating reserves to a Life PBR basis for business issued after the effective date and prior to the end of that three-year transition period.

This is a different transition framework from the one provided for in Actuarial Guideline 43 (AG 43 or VA CARVM). The three-year elective transition period under AG 43 grades statutory reserves for the entire in-force portfolio of contracts issued from 1981 forward into AG 43 reserves over the three-year period.

PBR Tax Reserves

As pointed out in our March 2011 report, the Internal Revenue Code requires the tax reserve method used to calculate the Federally Prescribed Reserve (FPR) to be CRVM in the case of contracts covered by CRVM (see Section 807(d)(3)(A)(i)). Section 807(d)(3)(B)(i) further defines CRVM as "the Commissioners' Reserve Valuation Method prescribed by the National Association of Insurance Commissioners which is in effect on the date of issuance of the contact." In the case of *American Financial* (in which the NAIC filed an *amicus* brief), the Sixth Circuit court confirmed that the NAIC's definition of CARVM (or CRVM by extension) at the time of the contract's issuance governs for tax purposes. Our March 2011 report is consistent with this conclusion in stating that the valuation method used to calculate the FPR should be the

[1] The American Academy of Actuaries is a 17,000-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.

valuation method after it is adopted by the NAIC. Further, our March 2011 report concluded that after the effective date of PBR, the tax reserve valuation method would be based on PBR, independent of whether a company used PBR for statutory reserving.

However, the *American Financial* case also has been read by some tax experts to support the following rule: Where the NAIC specifies more than one permissible method of computing reserves, each of which is designated as a permissible interpretation of CARVM or CRVM, then the method elected for statutory reserves would govern for tax reserves. Under this interpretation of the tax law, if the NAIC were to establish that both PBR and CRVM as defined prior to the adoption of PBR are both appropriate "CRVM" methods during the three-year transition period, it is possible that the company could use either method for both statutory and tax purposes, depending on its election, as long as the same method is used consistently.

Conclusion

There is uncertainty as to whether the IRS will accept the interpretation of the tax law as stated in the paragraph directly above. If the IRS does not accept this interpretation of the tax law, then we believe that the conclusions in the original report are still correct.

However, if the IRS agrees that there can be more than one NAIC-prescribed CRVM during a transition period for tax purposes, it would promote statutory/tax consistency and facilitate implementation of PBR. It would be helpful in this regard for the NAIC to confirm clearly in the Valuation Manual (or elsewhere) that both current CRVM and PBR are acceptable "CRVM" during the three-year transition period. The Tax Work Group believes that this can be accomplished by adding the following sentence to VM-00, at the end of Section II. Reserve Requirements, Life Insurance Products, paragraph 3:

> "For contracts issued during the first three years following the operative date of the Valuation Manual, reserves established pursuant to either the applicable requirements of VM-A and VM-C or VM-20 shall be considered reserves established pursuant to the minimum reserve requirements of CRVM."

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Please contact John Meetz, the Academy's life policy analyst (meetz@actuary.org; 202/223-8196) if you have any questions.

Sincerely,

Barbara Gold, Chair
Tax Work Group
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