



AMERICAN ACADEMY *of* ACTUARIES

May 8, 2014

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

Mark Birdsall
Chair, Life Risk Based Capital Working Group
National Association of Insurance Commissioners

Dear Mike and Mark:

The American Academy of Actuaries¹ AG 43/C3P2 Work Group (Academy WG) appreciates the opportunity to comment on the proposed changes to Actuarial Guideline XLIII (AG 43) and C-3 Phase II (C3P2), which would add guidance for applying the requirements in AG 43 and C3P2 to Contingent Deferred Annuities (CDAs).

The Academy WG believes that neither changes nor additions are needed to AG 43 and C3P2 at this time. We believe that these documents provide principles that can be applied to new products such as CDAs. The focus should be on establishing (or adopting already established) processes to review and communicate questions and concerns regarding the application of AG 43 and C3P2, rather than modifying or adding to these requirements.

Under such a review process, if additional clarification of acceptable practices is needed, it can be communicated by using currently available tools.² To the extent current tools are not deemed sufficient, the review process put in place can include the development of additional tools.

In the longer term, the review of AG 43 and C3P2 requirements should become part of the review process being developed by the NAIC PBR Review Working Group and the PBR Valuation Analysis Working Group. The potential need for guidance in this situation is consistent with the issues being addressed by those working groups. The NAIC established these working groups, in part, for the review and clarification of principle-based approaches.

The Academy WG also believes any review of AG 43 and C3P2 should be part of the NAIC C3P2/AG 43 Subgroup review of the requirements in AG 43 and C3P2. The first step should be a review of AG 43 and C3P2 memoranda and sample standard scenario calculations from the

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.

² Currently available tools may include: 1) the Q&A processes for C3P2 and AG XXXVIII; 2) documenting practice in the current Variable Annuity Practice Note Work Group practice note on the Application of C-3 Phase II and Actuarial Guideline XLIII; and 3) documenting the preferred approaches in the Life Actuarial Task Force and Life Risk-Based Capital Working Group minutes.

companies issuing this business, with a focus on how they are applying these requirements to reflect that they do not own the underlying assets. The NAIC Subgroup would then be in a good position to understand what current practice is and whether it is comfortable with that practice. To the extent that current practice is consistent with the desired approach, this can be the basis for guidance and/or clarification that can be provided to future entrants into the CDA marketplace.

Our comments below specifically address the Stochastic Calculation and the Standard Scenario.

Stochastic Calculation

We believe that changes to AG 43 and C3P2 are not needed for the stochastic calculation (i.e., the Conditional Tail Expectation Approach in AG 43 and the Modeling Methodology in C3P2). While CDAs did not exist at the time these requirements were developed, similar benefits such as a group life contract that wraps a guaranteed minimum death benefit around a mutual fund of this type did exist. It is clear to us that the CDA products that have been discussed fall within the scope of AG 43 and C3P2 as currently written. In addition, the current treatment of CDA products that have been discussed is covered by the current principles and requirements of AG 43 and C3P2. That is, all of the items discussed in the exposed document pertaining to the stochastic approaches are consistent with the current version of the requirements in AG 43 and C3P2.

We are also concerned about the precedent of adding guidance for new products. Doing so could result in the need to add guidance every time a new product is developed, a practice that was considered to be an unfavorable consequence of the prior version of the NAIC Model Standard Valuation Law and one of the reasons for pursuing principle-based approaches.

The specific guidance provided might not work for future versions of CDAs, or even other products. For example, while using a Working Reserve of zero may make sense for the CDA products that have been discussed, a different Working Reserve may be necessary for a future version of a CDA that may contain a cash surrender value. Providing additional guidance might result in inappropriate treatment for future versions of the product. This may then also require additional changes to provide more guidance for the future version.

Standard Scenario

We don't believe changes are needed to either AG 43 or C3P2 for the Standard Scenario. This is because the CDA contract should be recognized as providing a benefit relative to funds that are not part of the contract, considering that for the CDA products that have been discussed:

- There are guaranteed benefits defined by the CDA that are based on an account value external to the CDA contract, but integral to defining the benefits;
- There are no separate account assets owned by the insurer that support the CDA contract and there are no general account options (for the CDA products discussed, this should result in a zero basic adjusted reserve);
- Since the account value is external to the CDA contract, there are no account value based margins received by the company (i.e., the company's account value for the CDA contract is zero); and
- There are benefits based on both the definitions within the CDA contract and the associated account values, which are projected as described in the Standard Scenario to determine the benefits.

We understand this is one possible interpretation of the requirement and that external clarification may be educational. This can be accomplished using the review process and tools discussed above.

We do recognize there may be situations where it may make sense to *consider* amending AG 43 for new products, since the Standard Scenario is not a principle-based approach. However, we believe changes should be made only to the extent that the current Standard Scenario requirements do not properly address the characteristics of that new product. (During the development of AG 43 and C3P2, the Academy Variable Annuity Reserve Work Group and Life Capital Adequacy Subcommittee noted that because of the rule-based nature of the Standard Scenario, changes might be needed for new products.) Any such action should be taken only to the extent that the review process discussed above has been exhausted, and should be done in a way that is the least intrusive (i.e., the simplest way possible). It is also important to note that modifications to the Standard Scenario to address CDA contracts should be implemented in a way that does not result in any change to the current treatment for contracts where the insurer owns the underlying assets.

Other Proposed Changes

The Academy WG believes the proposed addition to the Background section of AG 43 under Other Proposed Changes is not necessary. The proposed language is already used in the Scope (section II)A)4)), which is the section that conveys the requirement (the Background section is not meant to be authoritative). Adding this language indicates that there is a discomfort with applying AG43 as it stands. As noted above, we believe the Scope section of AG 43 clearly brings these products into the scope of AG 43. A similar comment applies to the proposal to add language to Footnote 2 in C2P2.

We are concerned that the proposed changes to the definition of “separate account” could result in unintended consequences. For example, the term “separate account” is used 21 times in AG 43. Some of these references impact the CDA issues intended to be addressed by the proposal, but others deal with allocation (which is a rules-based construct for accounting purposes) and the starting asset amount (which should not have any separate account portion for CDAs). If any clarification is needed, this should be handled through the review process discussed above, and should focus on ways in which to work the current definition of separate account into specific circumstance (such as for situations where the insurer does not own the underlying assets) rather than redefining the term for specific products.

If you have any questions, please contact Academy Life Policy Analyst John Meetz (202-223-8196; meetz@actuary.org).

Sincerely,

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cc: Peter Weber, Chair, NAIC C3P2/AG 43 Working Group
Andy Ferris, Chairperson, Academy Contingent Annuity Work Group
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