AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.™

August 28, 2017

Mr. Mike Boerner
Chair, Life Actuarial Task Force
National Association of Insurance Commissioners
Via email: Reggie Mazyck (rmazyck@naic.org)

Re: VM Maintenance Agenda Item 2017-40

Dear Mr. Boerner,

The Life Reserves Work Group (LRWG) of the American Academy of Actuaries[1] is pleased to offer our comments on the exposed VM-20 Amendment Proposal Form (APF) on term insurance riders, labeled VM Maintenance Agenda Item 2017-40.

LRWG comments are focused on the modeled reserve components of VM-20 Section 4—Deterministic Reserve and Section 5—Stochastic Reserve.

Background

Section II—*Reserve Requirements* has a subsection, "Riders and Supplemental Benefits." These requirements are bifurcated into two paragraphs depending on whether the rider or supplemental benefit has a separately identified premium or charge. For such benefits with a separately identified premium or charge, the following sub-paragraphs potentially apply to term insurance riders, with emphasis added:

1.b For term life insurance riders on persons other than the named insured[s] on the base policy, the reserve **may be** computed separate from the base policy following the reserve requirements for that benefit;

1.c For term life insurance riders on the named insured[s] on the base policy, the reserve **shall be** valued as part of the base policy;

1.d For riders that enhance or modify the terms of the base contract, e.g., a secondary guarantee rider or a cash value enhancement rider, the reserve **shall be** valued as part of the base policy; and

[1] The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted 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.

1.e For any riders not addressed by paragraphs 1.b through 1.d above, the reserve **shall be** valued as part of the base policy.

For modeled reserve components (i.e., deterministic and stochastic reserves (DR, SR)) the original intent was to allow any rider to be valued together with the base contract. Specifically, the inclusion of the rider benefit together with the base was required in the following situations:

- The term insurance rider covered the same insured risk as the base (item 1.c above);
- The rider (any type) modified the terms of the base (item 1.d above);
- The rider in question did not fall neatly into any of the descriptions provided, therefore valuing it with the base contract was the default position (item 1.e above).

Only in the situation where the term insurance rider covered a life other than the life insured by the base contract does the company have an option to value the rider separately from the base contract (item 1.b).

<u>Maintenance Agenda Item 2017-40</u>

Most recently, the VM-20 Section 2—*Minimum Reserve* requirements have introduced product groups. Such groups did not exist when the Section II "Riders and Supplemental Benefits" language was drafted. We agree with APF 2017-40 that the current structure of minimum reserve requirements is confusing with respect to term insurance riders. VM-20 Section 2 language does not appear to allow any combinations of, for example, a universal life with secondary guarantees (ULSG) policy with a term insurance rider benefit.

As a potential solution, APF 2017-40 would modify the Section II language such that sub-bullets b and c are collapsed into a revised single bullet stating, "For term life insurance riders, the reserve shall be computed separate from the base contract following the reserve requirements for term life insurance policies."

This proposed language is problematic when calculating the modeled reserve (DR and SR) for the following reasons:

- Term insurance riders attached to UL policies often influence the policy value because the charge for the additional term benefit is assessed through the cost of insurance mechanism. Valuing the rider separate from the base contract is not possible.
- Some term rider *premiums* are annually (or monthly) re-determined based on the performance of the base contract. An example of this can be found in certain participating whole life contracts.
- Likewise, some term rider *benefits* are annually (or monthly) re-determined based on the performance of the base contract.

Section II was written before the net premium reserve (NPR) was added to VM-20, and thus the requirements in Section II regarding whether or not to include riders and supplemental benefits in the base contract were directed toward the modeled reserve (DR and SR), and not the NPR. As a result, we believe the current guidance in Section 3 of VM-20 regarding the treatment of riders and supplemental benefits in the NPR calculations needs to be revised in order to be consistent with the requirements of Section II. Our comment letter is intended to point this out but not make specific suggestions regarding an approach for the NPR. However, we believe it is important that the treatment of term riders in the NPR calculation should result in the term rider ending up in the same product group (i.e., term, ULSG, or Other) that was used for the calculation of the DR and SR. This is important to ensure that the when the comparison is made between the NPR, DR, and SR per Section 2 of VM-20, the rider ends up in the same product group for all three components.

<u>LRWG Suggested Approach for Treatment of Term Riders in the DR and SR Calculations</u>

For the DR and SR calculation, the wording in Section II should be modified to reflect the following:

- A term insurance rider that modifies the terms of the base contract (or vice versa, a rider whose terms are modified by the base contract) is required to be valued as part of the base contract, regardless of whether the life insured under the rider is the same as or different from the life insured by the base contract.

  If the term insurance rider and base contract are valued together, then they are to be grouped together for exclusion testing and carrying out the calculations required by VM-20 Section 2.A. Term insurance riders valued together with the base contract are permitted to undergo the deterministic exclusion test and should follow the base contract requirements for eligibility for the deterministic exclusion test.

- Term insurance riders on the named insured[s] of the policy are required to be valued separately from the base contract if all of the following conditions are true:
  - The terms of the base policy are not modified by the rider;
  - The terms of the rider are not modified by the base contract; and
  - The term insurance rider has a separately identified premium.

  If the term insurance rider is valued separately from the base contract, then such riders should be treated as standalone term insurance policies for the purpose of exclusion testing and carrying out the calculations required by Section 2.A.

To summarize, we are proposing to require that the term rider be separated from the base policy if the three conditions are present (i.e., the rider doesn’t modify the terms of the base contract, the base contract doesn’t modify the terms of the rider, and there is a separately identified premium). In this case, the term rider will be treated as a term policy for the NPR, DR, and SR and won’t follow the reserve calculation requirements for the base contract. For example, if a term rider to a whole life (WL) contract meets the three conditions, then the term rider is treated as a term policy and goes into the “Term” bucket for the all three legs (NPR, DR, and SR) and the WL policy is treated as a standalone policy separate from the rider and goes into the “Other” bucket for all three legs (NPR, DR, and SR). That is, the term rider becomes a standalone term policy, and it doesn't matter what the underlying base contract is. The term rider and the base policy would end up in different buckets (unless the underlying base contract is a term contract).

If the term rider does not meet at least one of the three conditions, then the term rider must be treated as part of the base contract, and the term rider and base policy both follow the same reserve calculation requirements as the base contract, because the two can't be separated and a separate reserve for each can't be determined. For example, if the base contract is an ULSG policy, both the rider and the ULSG contract follow the requirements of VM-20 Section 3.B.5 and 6 for the NPR, and both would be in the "ULSG" bucket for all three legs (NPR, SR, and DR). If the base policy is WL or UL, then both the rider and the base contract would follow the old Commissioner's Reserve Valuation Method for the NPR and be in the "Other" bucket for all three legs (NPR, SR, and DR).

Thank you for the opportunity comment on this important topic.

*****

Should you have questions regarding these suggestions, please contact Ian Trepanier, the Academy's life policy analyst, at trepanier@actuary.org.

Sincerely,

Dave Neve, MAAA, FSA, CERA
Chairperson, Life Reserves Work Group
American Academy of Actuaries