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September 12, 2017

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

Re: Proposed changes to VM-31

Dear Mike:

On behalf of the VM-31 Review Subgroup of the PBR Governance Work Group of the American Academy of Actuaries,[1] I am pleased to offer comments on the exposed VM-31 Amendment Proposal Form (APF). Our comments are presented in the order in they would appear in VM-31.

Recommended changes to be made throughout the document

We recommend that the following changes be made throughout the document, as appropriate:

Use "policies" in connection with life insurance and "contracts" in connection with annuities. We recommend that "policies" be used in connection with life insurance and "contracts" in connection with annuities. When a provision covers both VM-20 and VM-21, we recommend "policies or contracts" be used. We note that the Valuation Manual is inconsistent in its use of "policies" and "contracts." In some places, "policies" appears to be used in connection with life insurance and "contracts" in connection with annuities. However, on occasion, "policies or contracts" is used in connection with life insurance. We recommend the NAIC address this inconsistency in the future, but our current recommendation applies only to VM-31.

Replace "Life PBR Actuarial Report" with "Life Insurance PBR Actuarial Report." We recommend that VM-31 use the term "Life Insurance PBR Actuarial Report" instead of "Life PBR Actuarial Report."

[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.

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<u>Changes to specific sections</u>

Section 2.A (2nd paragraph). It is unclear how "subreport" is being used in VM-31—is the VM-21 report a "subreport"? Noting that Section C is titled "Life PBR Actuarial Report" and Section D is titled "Variable Annuity PBR Actuarial Report," we recommend that the opening sentence of the third paragraph in Section 2.A be replaced by two sentences:

> "The PBR Actuarial Report shall consist of a Life Insurance PBR Actuarial Report and a Variable Annuity PBR Actuarial Report, as appropriate. Each of these reports shall consist of one or more sub-reports covering a group of policies or contracts."

The paragraph states that the subreports are for groups of policies "comprised of one or more model segments." Because VM-21 does not reference "model segments" and VM-G does not require that the groups of policies assigned to one or more qualified actuaries be comprised of policies from one or more model segments, we recommend the phrase "comprised of one or more model segments" be removed. If deemed necessary, the phrase could be moved to Section C.

Section 3.B.3. [Life] PBR Summary. Although the original wording of VM-31 and the proposed "Phase 3" redlined document both limit the PBR Summary to life insurance, we recommend that the summary cover both life insurance policies and variable annuity contracts. Including both in the summary will consolidate information that regulators may want to consider and allow discussions of company-wide risk management practices. To accomplish this, we recommend that the section <u>not</u> be relabeled "Life PBR Report" and that sections 3.B.5 and 3.B.6 be placed in a new section titled "Reserve Supplements," which could, in the future, include variable annuity reserve supplements. Section 3.B.3.f requires a description of material differences in methods, assumptions, and risk management practices among groups of policies covered by separate subreports not explained by product differences. While most methods, assumptions, and risk management practices for variable annuity contracts will differ from those for life insurance policies due to product differences, we believe it is still beneficial to have the comparison for certain assumptions or practices (e.g., economic assumptions for all products and risk management practices for variable life insurance and annuities). As such, we recommend the section be retained as is, with "policies" changed to "policies or contracts."

Section 3.C.3.b. Conservation of Deaths. We note that the original wording, "various sub-classes or mortality segments," reflects the current wording of VM-20 Section 9.C.2.d. We recommend that any change in the wording of this subsection be done at the same time that VM-20 is changed.

Section 3.C.3.e. **Adjustments for Changes in Practice.** We suggest the report also require similar disclosure relating to the exclusion of policies under VM-20 Section 9.C.2.f. This includes impaired lives, as well as those for which changes in COI charges, premiums, etc., may lead to changes in policyowner behavior.

Section 3.C.3.g. Company Experience. This subsection would seem to be better placed prior to Section 3.C.3.e.

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Section 3.C.3.i. Adjustments for Mortality Improvement. The word "historical" is redundant.

Section 3.C.3.k. Anticipated Experience Mortality, paragraphs (i)—(iv). We recommend that this section be retitled "Prudent Estimate Mortality." The term "anticipated experience assumptions" is defined in the current version of the Valuation Manual to be "company experience mortality rates described in Section [9.]C.2 (which excludes prescribed margins)." Paragraphs (i), (ii), (iii), and (iv) of Section 3.C.3.k are applied <u>after</u> company mortality is determined and thus describe aspects of the development of prudent estimate mortality assumptions, although a company may also have applied smoothing and adjustments for reasonable relationships to its own experience. It may be valuable to note that the definition of anticipated experience was changed in 2016, which may have caused inconsistencies in this subsection. We recommend replacing "description" with "identification" in paragraph (ii) and "is" should be "are" in paragraph (iv).

Section 3.C.3.k. Anticipated Experience Mortality, paragraph (v). Paragraph (v) <u>does</u> apply to anticipated experience mortality, which is either company experience mortality or applicable industry basic table mortality and should remain in Section 3.C.3.k. We recommend that this paragraph be reworded as follows to make it more consistent with the Valuation Manual:

> "Description and justification <u>of the mortality rates the company actually expects to emerge and a comparison of these rates to the anticipated experience rates defined in VM-20 Section 9.C.2</u>~~to support and demonstrate that the resulting anticipated experience assumptions are at least as great as those expected to actually emerge~~. The description should include the level of granularity at which the comparison is made (e.g., ordinary life, Term only, preferred term, etc.)"

Section 3.C.9.c. Past Practices and Policies. We recommend that the wording be made more general as follows:

> "Description of how the company's past NGE practices and established NGE policies were reflected in projected NGE amounts, including <u>a description of</u> the impact of interest rates or other market factors on past and projected premium scales<u>,</u> ~~and~~ cost of insurance scales, <u>and other NGEs</u>."

Section 3.C.9.d. Consistency. Typographical correction:

> "…how policyholder behavior assumptions are consistent with the NGE ~~**are**~~ assumed in the model."

Section 3.C.10.d. Stochastic Exclusion Test. We recommend clarification of the wording as follows:

> "…identification of which acceptable demonstration method listed under VM-20 Subsection 6.A.3.b was applied <u>or a statement that</u>~~, or if~~ another method acceptable to the

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> commissioner was applied, and the **~~component~~** details of the demonstration supporting the exclusion."

The word "component" is redundant.

Section 3.C.11.a. Impact of Individual Margins. We suggest the following change to the introductory phrase:

> "The impact on the deterministic reserve for each group of policies for which a separate deterministic reserve must be calculated of the ~~individual~~ margins ~~on the deterministic reserve~~ for each individual risk factor, or group of risk factors, that has a material impact on such~~the~~ deterministic reserve, determined for each model segment by subtracting (i) from (ii):"

Separate deterministic reserves must be calculated for the policies belonging to each product group within a group of policies, including model segments. While the calculation could be done for the model segments by adding up the reserves for each component deterministic reserve, doing so could obscure the desired information. Also, not all groups of policies are required to calculate a deterministic reserve. A group of policies may be assigned to a model segment and subsequently be found to be excluded from the calculation of the deterministic reserve. The proposed wording would clarify that the impact of individual margins need not be calculated for such groups. If this change is made, a corresponding change should be made to (i) and (ii), with "model segment" replaced by "group of policies."

Section 3.C.11.b. Impact of Aggregate Margins. Similar comments to those that apply to Section 3.C.11.a apply to Section 3.C.11.b, and we recommend corresponding changes be made.

Section 3.C.11.c. Impact of Implicit Margins. We recommend that the Guidance Note, with appropriate rewording, be placed in VM-20, Section 9.B, and not in VM-31.

Section 3.C.11.f. Impact of Aggregation. Aggregation may refer to either aggregation over scenarios, which is sometimes called "liability-side hedging" and only affects the stochastic reserve, or aggregation of expected cash flows, which affects both the stochastic and deterministic reserve. (It may also refer to the changing of reserve type, for example, from stochastic reserve to net premium reserve, which was the issue that led to the definition of product groups.) The original wording suggests that liability-side hedging was the intended subject. We would point out that aggregation of expected cash flows is a normal part of the modeling process, and describing all the impacts of this process would be onerous and not useful. We recommend that the original wording of the section be retained. Also, because the stochastic reserve for different product groups must be calculated separately, we recommend that the wording be changed as follows:

> "Summary of the impact of aggregation on each group of policies for which a~~the~~ separate stochastic reserve must be calculated."

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Section 3.C.13.a. Investment Officer on Investments. The investment officer certification needs to be modified due to the 50/50 limitation on reinvestment strategy. In order to comply with the 50/50 limitation of VM-20 Section 5.E.1.g, companies may decide to model an investment strategy that assumes a 50/50 mix of AA- and A-rated investments, which will likely be different from the company's actual investment strategy. We recommend that the certification should be modified as follows:

> "A certification from a duly authorized investment officer that the modeled ~~asset~~ investment strategy is consistent with the company's current investment strategy, except to the extent that it has been modified to facilitate compliance with the requirements of the Valuation Manual."

Section 3.C.13.b. Qualified Actuary on Investments. VM-20 does not require a qualified actuary to supply a certification regarding clearly defined hedging strategies. We recommend this subsection be removed.

Section 3.C.13.c. Senior Management on VM-G. VM-G does not require management to provide a certification and, in fact, makes clear that it does not expand the existing legal duties of senior management. We recommend that this subsection be removed.

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Thank you for the opportunity to comment on these proposed changes to VM-31. Should you have questions regarding these suggestions, please contact Ian Trepanier, the Academy's life policy analyst, at trepanier@actuary.org.

Sincerely,

Arnold A. Dicke, MAAA, FSA, CERA
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