

Preliminary Framework Elements for Fixed Annuity PBR

American Academy of Actuaries Annuity Reserves Work Group (ARWG)

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NAIC VM-22 (A) Subgroup Meeting—May 20, 2020

ARWG Objective

Objective: Propose a new statutory reserve methodology for fixed annuities that uses an actuarial framework to determine reserves based on the level and type of risk inherent in the contract.

ARWG Pillars of Objectiveⁱ

- 1) Appropriate Reflection of Risk—All else equal, greater risk in *moderately adverse conditions* requires greater statutory reserves, and vice-versa.
- 2) Comprehensive—The statutory reserve accounts for all *material risks covered in the Valuation Manual and inherent in product features and potential management actions* associated with the policies or contracts being valued.
- 3) Consistency Across Products—Statutory reserves between two contracts with *similar features and risks are consistent* given the same anticipated experience, regardless of product type.
- 4) Practicality and Appropriateness—*Balance principles above with an approach that is practical*, auditable, and able to be implemented.



ARWG Vision and Need

Vision: Provide Academy framework on principle-based reserve (PBR) methodology for fixed annuity products and promote consistency with existing PBR frameworks.

How ARWG Plans to Accomplish Vision

- a) Propose a PBR Approach—The ARWG plans to propose a CTE70 stochastic reserve calculation.¹
- b) Develop a Framework Deck—Develop a set of slides laying out various elements of methodology.
- c) Recommend Consistency With VM-21 Where Appropriate—Start with VM-21 methodology.

Why Fixed Annuity PBR now?

- Flexible Methodology—As new products emerge introducing greater optionality and reinvestment risk, there is greater need for a reserve methodology that appropriately captures the risks in these products.
- Extend Existing PBR Framework—Seek consistency between fixed annuities and life/variable annuities (VM-20/VM-21).

(1) The ARWG only proposes a PBR modeled reserve and will not include any formulaic or prescriptive floors in its proposal.



Preliminary Timeline

Fall 2019–Spring 2020

- Develop proposed fixed annuity PBR framework deck
- Begin initial modeling sensitivities for generic FIA w/guarantee

Summer 2020

- ARWG to present framework deck proposal to LATF

Fall 2020

- Seek LATF endorsement of PBR framework deck (w/feedback addressed)
- Valuation Manual language drafting efforts

Spring 2021

- Begin industry field testing using draft (specifics TBD)

Spring 2022

- Target adoption of fixed annuity PBR (potentially VM-22)
- Target 1/1/2023 effective date (monitor as progress develops)



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ARWG Key Topics

1) Product Scope

- **Question:** Apply PBR to both deferred annuity and payout annuity contracts?
- **VM-20/VM-21 Treatment:** VM-20 applies PBR to all individual life products (including an exclusion test) and VM-21 applies PBR to all variable annuity products.
- **ARWG Perspective:** Recommend applying the PBR framework to both deferred and payout contracts. Not applying to immediate annuities allows companies to avoid principle-based reserves and creates possible advantages for some products over others, even if they share the same risks. That said, the recommendation is to hold off applying to Guaranteed Investment Contracts (GICs), funding agreements, and stable value contracts for the first round of fixed annuity PBR and revisit these at a later point in time.

2) Exclusion Test Methodology

- **Question:** Allow for exclusion test on new business that follows a similar framework to the VM-20?
- **VM-20/VM-21 Treatment:** VM-20 uses an exclusion test and VM-21 uses an Alternative Methodology.
- **ARWG Perspective:** Recommend following an exclusion test similar to the framework outlined in VM-20, which includes following a stochastic exclusion ratio test or certification method test. Products that pass the exclusion test are deemed to have lower levels of market risk and policyholder optionality risk and, therefore, may elect to use the pre-PBR Commissioners' Annuity Reserve Valuation Method (CARVM) reserve standards (i.e., AG33, current VM-22, AG35, etc.).



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ARWG Key Topics

3) Net Assets and Reinvestment Mix

- **Question:** Use company-specific spread, defaults, and reinvestment mix?
- **VM-20/VM-21 Treatment:** Use fixed-income reinvestment limits of 50% A / 50% AA and prescribed defaults and reinvestment spreads for fixed-income general account assets.
- **ARWG Perspective:**
 - The primary driver for fixed annuity modeled reserves is general account investments, whereas this may not necessarily be the case for variable annuities and life insurance (mortality-dependent).
 - Given the emphasis on general account spread for fixed annuity products, consider reflecting company-specific prudent estimates for defaults and reinvestment spreads for up to 4 years and grading into the current VM prescribed assumptions by year 7, as justified through back-testing and sufficient/credible historical data.
 - Require documentation of historical performance and must reflect company-specific prudent estimates and anticipated experience if resulting in a higher reserve than if reflecting VM prescribed assumptions in all years.
 - The current VM-20/VM-21 reinvestment 50% A / 50% AA fixed-income guardrail does not reflect industry reinvestment experience, so would suggest revisiting and consider removing.
 - Recommend not only making these changes for VM-22 PBR, but also VM-20/VM-21 for consistency across the treatment of general account assets.



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ARWG Key Topics

4) Aggregation

- **Question:** Permit aggregation across various fixed annuity and payout contracts?
- **VM-20/VM-21 Treatment:** VM-21 permits aggregation across contracts; VM-20 permits aggregation within term vs. ULSG vs. other buckets.
- **ARWG Perspective:** Aggregate across fixed annuity contracts, whether payouts or deferred, based on a set of outlined principles (including whether policies are part of the same integrated risk management system, managed/administered together, same or similar asset portfolios, etc.), but with no pre-defined buckets restricting aggregation.

5) Inforce Application

- **Question:** Make fixed annuity PBR retrospective to inforce policies? This includes policies issued not only back to the NAIC Valuation Manual Operative Date (1/1/2017), but also to pre-2017-issued contracts.
- **VM-20/VM-21 Treatment:** VM-21 applies to inforce and VM-20 applies only to business issued after the implementation date (1/1/2017 to 1/1/2020 depending on company election).
- **ARWG Perspective:** Still need to investigate further before forming recommendation, but believe there may be merits to exploring eventual inforce application (consistency across risks and products and more principle-based).



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Questions?

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