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March 4, 2022

Ben Slutsker, Chair
Valuation Manual (VM)-22 (A) Subgroup
National Association of Insurance Commissioners (NAIC)

Dear Mr. Slutsker,

During a discussion at a Valuation Manual (VM)-22 (A) Subgroup meeting, the American Academy of Actuaries[1] Annuity Reserves and Capital Work Group (ARCWG) volunteered to develop a "pros and cons" list of considerations around less aggregation vs. greater aggregation of blocks of business under VM-22. The work group has chosen to pose those considerations in the below format in this letter and the related Exhibit. The ARCWG is pleased to provide comment on the attached "ARCWG VM-22 Framework Exposure July 21, 2021-w Reserve Category and Product Descriptions final," ("Exposure").

For your reference, listed below and attached are the aggregation principles set out in "ARWG Preliminary Framework Oct 2020—Aggregation," an excerpt from the document entitled "Preliminary Framework Elements for Fixed Annuity PBR" dated October 2020(Framework):

Recommendation: Aggregate based on established set of principles related to how risks are managed.

1) Permit aggregation if the groups of policies follow the below outlined principles: Aggregate in a manner that is consistent with risk management strategy and reflects the likelihood of any change in risk offsets that could arise from shifts between product types (consistent with VM-20/VM-21);
2) Do not aggregate for groups of policies for which the business and risks are managed separately or are not part of the same integrated risk management program (consistent with VM-20/VM-21);
3) Using prudent actuarial judgment, consider the following elements when aggregating: whether groups of policies are part of the same portfolio (or different portfolios that interact), the same integrated risk management system, administered/managed together; and
4) Use same aggregation principles for exclusion testing, (CTE) 70 calculation grouping, and comparisons to final reserve components.

[1] The American Academy of Actuaries is a 19,500-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.

Examples provided in the Framework are:

1) Should not be aggregated—Group pension risk transfer (PRT) business and individual single premium deferred annuities (SPDAs) are managed in separate departments and priced and administered independently; and
2) Should be aggregated—Single premium immediate annuities (SPIAs) and fixed indexed annuities (FIAs) with guaranteed living benefits are managed in the same department and follow the same risk management program.

To expand on the Framework aggregation example, if all deferred and payout contracts were managed together and followed the same risk program, the ARCWG would suggest aggregating those blocks for principle-based reserving (PBR) purposes. If an actuary believes that the aggregation of blocks of business that would run counter to general guidance in VM-22 is nevertheless appropriate, the ARCWG suggests language that permits domiciliary state approval of such exceptions. The VM-31 report would include the rationale for the exceptional aggregation as well as documentation of the granted permission.

The ARCWG also emphasizes that how the risks are managed across multiple blocks of business may be a greater driver in determining the level of aggregation as opposed to where the business is administered. To the extent that the administration of blocks of business in different departments of the same company informs whether or not the company manages such risks together for investment planning, in force management, and developing an enterprise risk framework, it may be considered for determining aggregation, but how blocks are administered should not itself be a driver of such aggregation.

As the various principles indicate, the ARCWG suggests that the level of aggregation relate to a company's risk management practices and its capital testing practices. Companies that choose to write and manage lines of business that diversify risk should be able to reflect those diversification benefits in their principle-based reserves (PBR). PBR is intended to provide a flexible structure to properly recognize risks inherent in the blocks of business written, with margin such that reserves are adequate under moderately adverse conditions.

The ARCWG suggests that risk be broadly recognized for aggregation purposes. In addition, risk can be both asset- and liability-related. For example, blocks managed within the same portfolio will naturally be better matched from an asset/liability matching (ALM) perspective and should generate a lower reserve, all else being equal. If the blocks managed together cannot be aggregated, several issues may arise; e.g., it may be unclear how to appropriately assign the assets to the various blocks. Also, if risk diversification does not provide an offset, that will be reflected in the reserve. For example, if projected spreads are compressed and mortality improves, a company with fixed deferred annuities and SPIAs will see the PBR increase, all else being equal. In addition, aggregation can provide diversification benefits. In a scenario where interest rates sharply rise, fixed deferred annuities may have projected disintermediation losses that can be partially offset by higher future SPIA reinvestment yields. The impact on the PBR reserve will naturally reflect the relative sizes of the blocks and risks being aggregated.

Exposure Comments

In light of the views on aggregation expressed above, the ARCWG offers the following comments on the Exposure. The ARCWG suggests it may be appropriate to group, for aggregation purposes, products that have risks that are managed together across the company, and that it should be left to the interpretation of the actuary to demonstrate exactly what this means. One example may be grouping policies that belong to the same asset segment. If there is no asset segmentation, this may lead to aggregating across contracts. Any demonstration and rationale should be provided as part of the VM-31 Report. In addition, in various VM-22 Subgroup meetings, the concept of a “Reserving Category” vs. a “Subgrouping” has come up. The ARCWG suggests that only one term is needed for VM-22 and recommends “Reserving Category.”

The ARCWG also notes that actuaries need to understand the risks inherent in each block of policies. Any significant risks in individual blocks or highly sensitive assumptions that would materially increase reserves should be disclosed as part of the VM-31 Report. In addition, actuaries should be able to justify their position on whether reserves in excess of VM-22 reserves must be held.

The ARCWG encourages efforts to model actual blocks of business and better understand the practical impact of either less or more aggregation as is currently planned for the VM-22 field test. Such modeling should help set the proper level of aggregation reflective of the various considerations around aggregation.

The attached exhibit shows support for more aggregation as well as support for less aggregation—i.e., multiple reserving categories. The exhibit also identifies other aggregation considerations not specifically discussed here. The ARCWG would be pleased to answer any questions you might have or requests for additional information.

Sincerely,
Chris Conrad
Chair, Annuity Reserves and Capital Work Group
American Academy of Actuaries

CC: Reggie Mazyck, NAIC

ARCWG VM-22 Framework Exposur

ARWG Preliminary Framework Oct 202(

Exhibit: Greater Aggregation vs. More Reserving Categories

Number	Name	Support of Greater Aggregation	Support of Multiple Reserving Categories
1	Consistency With Other Valuation Manual Chapters	Broad aggregation is consistent with VM-21.	Depending on the number of reserving categories, may be similar to VM-20 separating term vs. universal life with secondary guarantees (ULSG) vs. other (noting some current proposals require more categories than VM-20).
2	Reflection of Risks	Greater aggregation better captures how actual risks emerge and are managed by insurance companies.	Multiple reserving categories is closer to individual contract reserving.
3	Intended Level of Prudence	Aggregation will tend to keep the level of conservatism in reserves closer to the intended target e.g., CTE70. For example, if sufficiencies offset deficiencies, aggregation will help to reduce excess conservatism.	Multiple reserve categories will tend to raise the level of conservatism above the intended target, e.g., CTE70, when aggregation provides risk offsets.
4	Diversification Benefits	Allowing broad aggregation permits recognition of risk management practices through managing similar annuity product types across general accounts. Reflects diversification benefits across contracts in different durations, population characteristics, and contract options being less than 100% correlated.	Multiple reserving categories will help reduce or eliminate interaction across contracts. Instead, aggregation offsets may be reflected through Asset Adequacy and C-3 Testing.
5	Transparency of Margin	Aggregation can reflect appropriate risk offsets while explicit margins can reflect conservatism in excess of an economic reserve. Risk disclosure and margin support can be included in the VM-31 Report.	Aggregation makes it less clear which individual groups of contracts carry greater risks, thereby requiring more disclosures to differentiate risks across different contracts and assumption categories.
6	Implementation and Auditability	Aggregation may ease implementation efforts if a similar framework is ultimately used for capital purposes, as the two calculations would be more consistent. Aggregation may also reduce the number of models, potential for coding errors and model governance needed. Aggregation may also ease the process of assigning assets to blocks in the PBR modeling. Actuaries are expected to work with regulators to develop an end-to-end auditable framework.	May be easier to compare and analyze model (or models) results that operates at a lower level of granularity across products. To increase transparency, actuaries are expected to understand risks in the blocks of policies and provide appropriate disclosure in the VM-31 report. Actuaries are expected to work with regulators to develop an end-to-end auditable framework.

7	Consistency With the Accounting Procedures and Practice Manual (APPM)	Aggregating policies still allows statutory reserves to be calculated at the individual policy level through allocation methods, in line with statutory requirements and current VM-20/VM-21 methods. Statement of Statutory Accounting Principle (SSAP) 50 defines multiple categories, but the latest proposed guidance notes go beyond the definitions in SSAP 50. If the idea is to better measure individual risks, such can be accomplished more intentionally through margins on assumptions and sensitivity testing than by restricting aggregation.	SSAP 50 has six categories of annuities. Splitting out categories, such as deferred and payout, may be more consistent with such definitions. In addition, SSAP 50, SSAP 51, and Appendix A-791 have multiple sections encouraging specific risks to be distinguished from each other, which may be easier to capture by removing aggregation of risks across multiple contracts. Aggregation at a very high level may result in a reserve at the policy level that does not make sense.