March 11, 2026

Rachel Hemphill, Chair
Life Actuarial (A) Task Force (LATF)
National Association of Insurance Commissioners (NAIC)

Re: Principles for applying an Illiquidity Spread in PBR calculations

Dear Chair Hemphill:

On behalf of the Annuity Reserves and Capital Subcommittee (ARCS) of the American Academy of Actuaries,[1] I appreciate the opportunity to respond to LATF's Feb. 5 request of the Academy to provide principles that can be used in determining an appropriate illiquidity spread in any Pension-Risk Transfer (PRT) guardrail that may be introduced to the Valuation Manual (VM).

Scope of Proposal

The ARCS believes that a principles-based view of a potential illiquidity spread must be considered holistically across the VM, as opposed to only PRT. Additionally, the ARCS believes that the principles discussed below should not necessarily be limited only to a certain product type or category but should instead be applied based on the underlying asset portfolio and liability characteristics.

The VM currently applies restrictions on assets that may have higher net spreads due to embedded illiquidity premium in two ways. First, the net spread adjustment is applied on in force assets when the net spread exceeds a regulatory threshold (net spread on a BBB public noncallable bond). Second, net yields on reinvestment assets are constrained to a fixed income guardrail that contains only public noncallable bonds and Treasuries of a specified credit quality. With respect to both in force and reinvestment assets, some companies for some products may allocate to less liquid or illiquid assets that result in higher net spreads in their ALM practice. Subject to the principles laid out below, the ARCS believes that it would be appropriate to reflect some portion of the illiquidity premia principles to both in force and reinvestment assets subject to an appropriate margin consistent with the reserve objective level.

Principles

The ARCS has drafted the following principles to evaluate what portion of illiquidity premium could be appropriate to recognize in either the in force net spread calculation and/or reinvestment assumptions. These principles are not opining on potential caps, floors, or other restrictions.

Principle 1—The objective of applying an additional illiquidity premium is to reflect the underlying characteristics of the assets and liabilities of certain types of business where both 1) the underlying liability is either fixed or exhibits a limited range of variability across a range of moderately adverse economic scenarios, and 2) the liability is supported by assets that are less liquid than public noncallable corporate

[1] The American Academy of Actuaries is a 20,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 60 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.

bonds. In order for any portion of the illiquidity premium to be recognized, both criteria should be met. Not all portfolios and Asset Liability Management (ALM) strategies backing liabilities, either fixed or those exhibiting a limited range of variability, will ultimately calculate an illiquidity premium greater than zero according to these principles.

Principle 2—We believe that the illiquidity premium should be evaluated and applied at a granular level. Assets should be grouped for purposes of determining and applying the illiquidity premium only when their cashflows, market values, and responsiveness to economic scenarios are expected to be substantially similar within the grouping. For structured securities, assets should be grouped for illiquidity premium purposes only when the underlying collateral and the characteristics of the investment structure are sufficiently homogeneous.

Principle 3—Less liquid and illiquid assets may have more complex risk profiles, including sensitivity to economic factors not modeled directly in the GOES scenarios. In some cases, the liquidity premium may exist as a result of the complexity of the assets. It is appropriate to recognize and calculate an illiquidity premium only 1) when a company has a process in place to identify and monitor the risk factors to which the asset class is exposed, 2) when the company models within the PBR model those risks identified as material by the aforementioned monitoring process, 3) when such modeling is performed at a sufficient level of granularity to capture the material risk factors that impact the cashflows and market values of the less liquid or illiquid assets, and 4) when the liquidity needs (e.g., the need for posting of initial margin or variation margin) of the company's hedging strategies and other ALM practices associated with the less liquid or illiquid assets are also reflected in the PBR model.

For structured securities, modeling should capture the economic dynamics and risk factors that impact both the underlying collateral and the structured security itself.

Principle 4—If the illiquidity premium is a fixed amount used across all scenarios, when performing the calculation for the liquidity premium, a company should be able to justify the value over a range of moderately adverse scenarios.

Principle 5—Using a flat illiquidity premium for an entire class of assets across all economic scenarios would not necessarily be appropriately granular to comport with these principles, unless the amount of the premium is sufficiently conservative as to be expected to exist across a range of moderately adverse economic scenarios.

Principle 6—The calculation of the illiquidity premium shall only be performed for assets that have a sufficient volume of available historical data. Where possible, the historical data used should cover multiple economic cycles, including periods of stress for the asset class. Where historical data for the asset class does not include periods of stress, the illiquidity premium should consider potential outcomes over a range of moderately adverse scenarios when contractual principal and/or interest payments may be delayed or may not be paid at all.

For recognition of the illiquidity premium for reinvestment purposes, the asset class should also have a high likelihood of future availability over the reinvestment horizon appropriate to the liability (e.g., over a X-year period for a liability for which [a high %] of the total reinvestment activity is required during the first X years). To the extent there is doubt about the availability or illiquidity premium that may exist on the reinvestment assets in future periods, it may be appropriate to haircut the amount of illiquidity premium recognized or to apply it only over a limited horizon.

The relevant data and analysis used to develop the illiquidity premium assumptions for each applicable asset class should be disclosed in the VM-31 report.

Principle 7—The calculation of the illiquidity premium shall be done on a net spread basis and should account for differences in defaults and investment expenses in order to justify the additional net spread on top of public noncallable bonds in the fixed income reinvestment guardrail. For structured securities, care should be applied to ensure that all fees and expenses across both the underlying collateral and the structure itself are appropriately considered in the modeling.

These principles can be included as a new VM-22 section 12.E.

Thank you for your consideration of these comments. Please contact Amanda Barry-Moilanen (barrymoilanen@actuary.org), the Academy's policy project manager, life, with any questions on this comment letter.

Sincerely,
Bruce Friedland, MAAA, FSA
Chairperson, Annuity Reserves and Capital Subcommittee
American Academy of Actuaries