February 27, 2015

Mr. Felix Schirripa
Chair, NAIC LATF VM-22 Sub-Group

Re VM-22 Annuity PBR Initiative

Dear Felix:

The ACLI1 is pleased to submit the following comments on behalf of our member companies in response to your request that interested parties outline any concerns with the directions being considered. The NAIC has hosted a variety of NAIC meeting presentations or VM-22 sub-group calls which have discussed a Principle-Based Reserve (PBR) approach for statutory reserves for non-variable annuities. After reviewing these various communications, the ACLI wishes to offer the following comments related to the non-variable annuity PBR initiative (VM-22).

General Views
In the development of VM-22, the ACLI has several general views. We believe that formulaic approaches should continue to be used where they produce an appropriate reserve, and modeling approaches used where that approach is needed to appropriately value the product’s risk and liability. Our other views include the following:

- **Complexity** – The VM-22 methodology is being developed to include both a formulaic component and a cash flow modeling component. Similar to the structure of Life PBR, we believe the modeling approach should be required only in those instances where the products have material guarantees or options that require a more rigorous reserve calculation process. For many annuity products, we believe that an enhanced formulaic approach would form a reserve level without requiring a resource intensive modeling approach. Unlike Life PBR, we

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1 The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 284 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Learn more at www.acli.com.
believe the annuity reserve method should default to the enhanced formulaic CARVM approach, and only require modeling when specific defined criteria exist that requires the additional rigor of a cash flow modeling approach. The level of rigor and documentation required in the PBR method should be reasonable and proportional to reflect the level of the underlying risk.

- **New Business** – We believe the VM-22 method, including any CARVM enhancements, should be applied prospectively to new business issued on or after the non-variable annuity PBR effective date.

- **Field Testing** – The VM-22 proposal could have a significant impact on the annuity market place as well as insurer systems. Annuity products may need to be re-designed or re-priced to reflect the potential impacts of VM-22. For these reasons, the ACLI is requesting that there be a transparent and thorough test of a stable proposal similar to the Impact Study commissioned by the NAIC for Life PBR, with adjustments as uncovered by the testing, prior to implementation. We appreciate the work of the KS field test as a proof of concept, but do not view its limited scope as adequate for a field test.

- **Reserve Levels** – The ACLI supports non-variable annuity PBR levels that are sufficient to withstand moderately adverse, but not extreme, conditions. VM-22 reserves should appropriately reflect all of the material risks in products, and provide for a reserve methodology that allows for reserve levels that could be either higher or lower than the levels that would be produced by current valuation requirements.

- **Risk Mitigation** – We believe the VM-22 reserve method should appropriately reflect risk mitigation, and not create a disincentive for insurers to use risk mitigation strategies such as reinsurance, derivatives, asset liability management and diversification. Appropriate reflection of risk in our view implies that the statutory and economic reserves would be directionally consistent.

- **Federal Income Tax** – The VM-22 method should be compatible with the federal income tax code.

- **Timing** – We urge the NAIC to follow a measured pace in the release of non-variable annuity PBR requirements, perhaps considering a phased implementation. In addition, we believe that it would be beneficial for regulators and insurers to incorporate lessons learned from Life PBR as well as the results of future VM-22 field tests.

**PBR Methodology**

- **Scope of Products** – The charge of the VM-22 subgroup is “Pose a PBR methodology for non-variable (fixed) annuities for consideration by the Life Actuarial (A) Task Force.” We think there needs to be a discussion of the scope of VM-22, and whether all annuity products not in scope of VM-21 / AG-43 can
and will be covered by a single set of reserve requirements in VM-22. The variety and volume of annuity products is far greater than the life products covered by VM-20. In particular, group products have a much greater role in the annuity market. This will require a discussion about appropriate standards for individual versus group, and the various types of coverages/products within each as well as true fixed products and so-called hybrid designs. There will also need to be careful coordination and clarity to ensure that products are not subject to duplicative or conflicting requirements.

• **Documentation of Development Work** – In 2013 and 2014, there have been some presentations from the Kansas Insurance Department and the American Academy of Actuaries (AAA) that have discussed the non-variable annuity PBR method under development. While we’ve found these presentations informative, clear documentation of the various methods, assumptions, and tests is needed for those not part of the development and testing process to understand what is being developed and how the different parts interact. This information would enable the ACLI and other interested parties to provide informed comments on the proposal as well as the analysis completed.

• **VM-22 Methodology** – From initial discussions, the modeling methodology being considered / developed is different in many aspects from either the current AG-43 as well as Life PBR. Some of the techniques appear to be new and unproven. This could have a material impact on company financials, and on the future design of products. We encourage careful deliberation of these new methods both for actuarial soundness as well as consistency with the NAIC Solvency framework

• **CARVM Enhancements** – In addition to designing the modeling methods for VM-22, we also recommend that the VM-22 sub-group consider enhancing the existing CARVM formulaic methodology and assumptions. This formulaic requirement will most likely form the basis of a reserve floor and may potentially remove the need for a more robust / resource intensive modeling approach for some products. We will continue to review this for more specific recommendations but believe that some of the concerns raised about annuity reserves can be addressed with formulaic solutions.

We hope you find these views helpful, and we look forward to commenting upon the VM-22 methodology.

Sincerely,

[Signature]

cc Reggie Mazyck, NAIC