

**Brian Bayerle**  
Senior Actuary

December 18, 2020

Mr. Bruce Sartain  
Chair, NAIC VM-22 (A) Subgroup

Re: ARWG Preliminary Framework

Dear Mr. Sartain:

The American Council of Life Insurers (ACLI) appreciates the opportunity to submit the following comments on the exposed presentation deck on the Academy Annuity Reserve Working Group (ARWG) preliminary framework for fixed annuity PBR.

ACLI is appreciative of the hard work of the ARWG in developing the framework for fixed annuity PBR. We believe the framework is going in the right direction, and we offer the following feedback on the five directed topics and additional comments:

1. Reinvestment Mix

We believe the 50% A / 50% AA fixed income reinvestment guardrail should be revisited, and regulators should consider using a more industry-consistent reinvestment mix in VM-22 and other principle-based reserves. As credit spreads and defaults are already prescribed, this level of conservatism in the reinvestment mix should not be necessary. Revisiting this reinvestment restriction for all products was also flagged for LATF review by the NAIC staff letter and a VM-21 drafting note. We would support the use of VM-22 credit quality mix as asset mix limitation for VM-22 reinvestment assets as proposed by the ARWG as it is reasonably industry-consistent for products in scope of VM-22. The VM-22 spread reflects an average credit quality of approximately 'A' to 'A-', which we believe is representative of fixed annuity market pricing and investing practices and is therefore an appropriate level for principle-based reserving.

2. Index Credit Hedging Treatment

We agree that modeling hedge breakage seems reasonable and appropriate. The index credit hedge breakage simplification seems like a potentially reasonable option for those that do not model their hedge program explicitly or manage market risks from their products more holistically; we believe it should be an optional simplification and not a requirement. We believe, however, that the proposed 1% floor factor can be too low in some instances. Static and dynamic hedges should

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have different breakage expenses as dynamic hedges should have a higher minimum breakage expense given the inherent uncertainty of hedge income actually realized. For static hedging strategies, whereby the replicating portfolio of financial instruments is purchased at the index segment inception, a 1% floor on the hedge cost expressed as a percentage of the interest credited might be reasonable (but should be tested to determine whether another level is more appropriate). However, for dynamic hedging strategies that do not lock in the index crediting amount at segment inception, a 1% floor is likely too low. Depending on the strategy, we believe a floor approaching the 5% floor within VM-21 would be appropriate, as such strategies show more hedge ineffectiveness during periods of market stress than static hedge programs.

Additionally, we believe that there should be more discussion on the treatment of reflecting management actions in the reserve, such as index credits, caps, and management of hedge gains and losses and defaults.

### 3. Aggregation

Aggregation should be primarily driven by how assets are managed, since that is how the company views risk/return trade-offs. Companies already aggregate for other purposes including C3P1 and asset adequacy; the economic scenario that actually materializes will be the same for all business, and it would not make sense to calculate results separately and hold reserves for a product assuming rates spike and reserves for another product assuming that the same rates simultaneously decrease. Deviating from the level assets are managed would require arbitrary and/or complex asset allocations across blocks of business that could distort reserves, even if the allocation method is consistent over time. Concerns about shorter duration / less risky cash flows running off seem like a reserve pattern issue (rather than what is currently appropriate) that would be better addressed in the ORSA. Alternately, there could be an aggregation benefit disclosure.

### 4. Exclusion Testing

We support the inclusion of an exclusion test in VM-22, as well as a materiality threshold similar to the Life PBR Exemption. We believe that exclusion testing thresholds should be set based on the risks and field test results, rather than by a priori views about what should or should not pass. We do not believe longevity risk should be included in the ratio test for all products; rather, the test should limit its focus on ALM mismatch risk. Products with well-matched portfolios and only longevity risk do not necessarily need to be tested stochastically and should be able to pass the exclusion tests. Longevity risk can then be handled through the margins embedded in prescribed mortality assumptions. Alternatively, we support including a deterministic reserve option to handle payout contracts with longevity risk, similar to that described in the appendix of the exposure.

If there are products that regulators believe should always pass any exclusion test, regulators should consider if these products should be out of scope for VM-22. Where appropriate, it may be worth considering whether exclusion testing requirements could be simplified or potentially removed for certain products that regulators expect to pass to reduce the extra work of doing both an exclusion test and creating the required PBR documentation for these products (or as previously suggested something akin to the VM-20 Life PBR Exemption). This product-specific

guidance could also be addressed within VM-22 (for example, if FIAs without withdrawal benefits fall back on AG35, consider making the Iowa practice for indexed products part of VM-22).

#### 5. Allocation Methodology

We believe there should be flexibility around allocation, so long as it supports an acceptable tax reserve. We do not believe VM-22 allocation needs to be more prescriptive than VM-21. VM-22 should allow for company discretion to develop an allocation method consistent with VM-21. For example, for many products using NAR (value of benefits above CSV) would generally produce a similar result as the proposed methodology, without requiring additional complexity/runs. We also note that tracking GPVAD on a serialim basis is extremely complex and functionally impossible for companies who use crunched/cluster models.

#### 6. Scope

ACLI believes that whether a product falls under VM-21 or VM-22 should depend on the nature of the risk. Based on the nature of the risk, we believe that hybrid annuities and many structured annuity designs would be covered by VM-21. Further, we believe that funded and unfunded longevity reinsurance should fall within the scope of the existing VM-22. Finally, several categories from the existing VM-22 Scope section are not included in the slides (e.g., Supplementary Contracts, CDA's); we would like to understand if certain products were deliberately excluded at this time from the potential regulatory framework.

#### 7. Timeline

Target effective dates will need to be reconsidered if inforce business is included in VM-22 on either an optional or mandatory basis. The timeline should consider a later effective date for inforce than new business, alignment with C-3 Phase 1, and other considerations. Companies have a wide variety of systems and VM-20 and VM-21 processes do not necessarily support VM-22 required processes, so it is likely to require a very large build. A scope limited to new business would simplify the build because it would reflect the much smaller universe of products currently being developed and offered.

#### 8. Discount Rates and Starting Assets

We believe there should be alignment of discount rates and starting assets to the VM-21 methodology. We recommend revisiting borrowing cost restrictions (e.g., to avoid anomalies and/or be more principles-based) and aligning the approach across all products. During VM-21 development, regulators deliberately aligned asset requirements with VM-20, but ultimately the framework deviated from this and added the borrowing cost restriction to VM-21. The NAIC staff letter from the VA subgroup work and a VM-21 guidance note flagged this for future LATF review for all products.

#### 9. Mortality

We believe mortality should follow a principles-based approach consistent with VM-21 rather than the more prescriptive approach in VM-20. We believe it is appropriate for consistency of alignment between annuity products. Mortality curves in the “no data” case or for credibility weighting and mortality improvement should reflect appropriate experience / assumptions – including product differences, appropriate granularity, geographic / country differences, etc. It would be inappropriate to merely rely on VA mortality, and rather should consider updated SOA reports and studies (e.g., upcoming fixed deferred, individual payout, group payout, etc.).

#### 10. VM-31 Disclosures

We have the following comments on the disclosure recommendations:

- General Account Assets: A full reserve calculation may not be necessary. Appropriately documented simplifications that demonstrate why the reinvestment restrictions are more conservative should still be allowed (e.g., similar to VM-20, Section 2.G) if it is clear the reinvestment restriction will dominate instead of requiring 2 runs.
- Hedging: It is not clear whether the full contract fair value comparison is useful for VA, and it seems potentially even less useful for fixed annuities (e.g., for a plain vanilla FIA with hedged index credits).
- Dynamic Policyholder Behavior: This requirement seems redundant with existing requirements to provide rationales for assumptions and could perhaps be addressed with a guidance note.

We appreciate the consideration of our comments, and look forward to discussing on a future call. Thank you.

Sincerely,

A handwritten signature in cursive script, appearing to read "B. Bonfanti".

cc: Reggie Mazyck, NAIC