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| **Dates:** Received | Reviewed by Staff | Distributed | Considered |
| 4/13/21 | RM |  |  |
| **Notes:** APF 2021-05 | | | |

**Life Actuarial (A) Task Force/ Health Actuarial (B) Task Force**

**Amendment Proposal Form\***

1. Identify yourself, your affiliation and a very brief description (title) of the issue.

**Identification:** David Neve, VP and Consulting Actuary, Actuarial Resources Corporation

**Title of the Issue:** Clarify the definition of modeled company investment strategy and the comparison to the alternative investment strategy.

2. Identify the document, including the date if the document is “released for comment,” and the location in the document where the amendment is proposed:

January 1, 2020 NAIC *Valuation Manual*

* VM-01 VM-21 Section 4.D
* VM-20 Section 7.E VM-31 Sections 3.D.6 and 3.F.6

3. Show what changes are needed by providing a red-line version of the original verbiage with deletions and identify the verbiage to be deleted, inserted or changed by providing a red-line (turn on “track changes” in Word®) version of the verbiage. (You may do this through an attachment.)

See attached.

4. State the reason for the proposed amendment? (You may do this through an attachment.)

There is an inconsistency in VM-20/VM-21 and VM-31 regarding the term “model investment strategy”.  The term “model investment strategy” is used throughout VM-20 and VM-21 to describe the investment strategy used in the model as a proxy for the company’s actual investment strategy.   However, VM-31 uses the term “modeled company investment strategy” in several places rather than “model investment strategy”.   “Modeled company investment strategy” is the preferred term, so VM-20 and VM-21 have been modified to use “modeled company investment strategy” so that the terminology in VM-20, VM-21 and VM-31 are consistent.

Also, to address the ambiguity of whether the final investment strategy in the model is the initial investment strategy based on the company’s investment strategy or the alternative investment strategy when the alternative strategy is constraining, the term “modeled company investment strategy” has been added to the definitions in VM-01 (and a parenthetical has been added to VM-31) to clarify that the term refers to the investment strategy in the model prior to comparison to the alternative investment strategy. In addition, VM-21 has been modified to be consistent with the wording in VM-20 to clarify that the assets in the alternative investment strategy should use the same weighted average life (WAL) as the assets in the modeled company investment strategy.

**VM-01 Changes:**

VM-01 provides definitions for terms used in the *Valuation Manual*. The definitions in VM-01 do not apply to documents outside the *Valuation Manual* even if referenced or used by the *Valuation Manual*, such as the AP&P Manual. Some terms in the *Valuation Manual* may be defined in specific sections of the *Valuation Manual* instead of being defined in VM-01.

* The term “margin” means an amount included in the assumptions used to determine the modeled reserve that incorporates conservatism in the calculated value consistent with the requirements of the various sections of the *Valuation Manual*. It is intended to provide for estimation error and adverse deviation.
* The term “modeled company investment strategy” means the investment strategy used in the model that is intended to be a representation of the actual investment strategy of the company. It is before the comparison is made to the alternative investment strategy. It does not refer to the alternative investment strategy when the alternative investment strategy is constraining.
* The term “modeled reserve” means the deterministic reserve on the policies determined under VM-20 Section 2.A.1.a, 2.A.2.a and 2.A.3.b, plus the greater of the deterministic reserve and the stochastic reserve on the policies determined under Section 2.A.1.b, 2.A.2.b and 2.A.3.c.

**VM-20 Changes:**

### Section 7: Cash-Flow Models

E. Reinvestment Assets and Disinvestment

1. At the valuation date and each projection interval as appropriate, model the purchase of general account reinvestment assets with available cash and net asset and liability cash flows in a manner that is representative of and consistent with the company’s investment policy for each model segment, subject to the following requirements:

a. The modeled company investment strategy may incorporate a representation of the actual investment policy that ranges from relatively complex to relatively simple. In any case, the PBR Actuarial Report shall include documentation supporting the appropriateness of the representation relative to actual investment policy.

**Guidance Note:** A complex model representation may include, for example, illiquid or callable assets whereas a simple model representation may involve mapping of more complex assets to combinations of, for example, public non-callable corporate bonds, U.S. Treasuries and cash.

b. The final maturities and cash-flow structures of assets purchased in the model, such as the patterns of gross investment income and principal repayments or a fixed or floating rate interest basis, shall be determined by the company as part of the model representation.

c. The combination of price and structure for fixed income investments and derivative instruments associated with fixed income investments shall appropriately reflect the then-current U.S. Department of the Treasury (Treasury Department) curve along the relevant scenario and the requirements for gross asset spread assumptions stated below.

d. For purchases of public non-callable corporate bonds, use the gross asset spreads over Treasuries prescribed in Section 9.F.8.a through Section 9.F.8.c. (For purposes of this subsection, “public” incorporates both registered and 144a securities.) The prescribed spreads reflect current market conditions as of the model start date and grade to long-term conditions based on historical data at the start of projection year four.

e. For transactions of derivative instruments associated with fixed income investments, reflect the prescribed assumptions in Section 9.F.8.d for interest rate swap spreads.

f. For purchases of other fixed income investments, if included in the modeled company investment strategy, set assumed gross asset spreads over Treasuries in a manner that is consistent with, and results in reasonable relationships to, the prescribed spreads for public non-callable corporate bonds and interest rate swaps as defined in Section 9.F.8.

g. Notwithstanding the above requirements, the modeled reserve shall be the higher of that produced by the modeled company investment strategy and that produced by substituting an alternative investment strategy in which the fixed income reinvestment assets have the same weighted average life (WAL) as the reinvestment assets in the modeled company investment strategy and are all public non-callable corporate bonds with gross asset spreads, asset default costs and investment expenses by projection year that are consistent with a credit quality blend of 50% PBR credit rating 6 (A2/A) and 50% PBR credit rating 3 (Aa2/AA).

Policy loans, equities and derivative instruments associated with the execution of a clearly defined hedging strategy (in compliance with Section 7.L) are not affected by this requirement.

**Guidance Note:** VM-31 requires a demonstration of compliance with VM-20 Section 7.E.1.g. In many cases, particularly if the modeled company investment strategy does not involve callable assets, it is expected that the demonstration of compliance will not require running the reserve calculation twice. For example, an analysis of the weighted average net reinvestment spread on new purchases by projection year (gross spread minus prescribed default costs minus investment expenses) of the modeled company investment strategy compared to the weighted average net reinvestment spreads by projection year of the alternative strategy may suffice. The assumed mix of asset types, asset credit quality or the levels of non-prescribed spreads for other fixed income investments may need to be adjusted to achieve compliance.

**VM-21 Changes:**

### Section 4: Determination of the Stochastic Reserve

D. Projection of Assets

4. General Account Assets

a. General account assets shall be projected, net of projected defaults, using assumed investment returns consistent with their book value and expected to be realized in future periods as of the date of valuation. Initial assets that mature during the projection and positive cash flows projected for future periods shall be invested in a manner that is representative of and consistent with the company’s investment policy, subject to the following requirements:

i. The final maturities and cash flow structures of assets purchased in the model, such as the patterns of gross investment income and principal repayments or a fixed or floating rate interest basis, shall be determined by the company as part of the model representation;

ii. The combination of price and structure for fixed income investments and derivative instruments associated with fixed income investments shall appropriately reflect the projected Treasury Department curve along the relevant scenario and the requirements for gross asset spread assumptions stated below;

iii. For purchases of public non-callable corporate bonds, follow the requirements defined in VM-20 Sections 7.E, 7.F and 9.F. The prescribed spreads reflect current market conditions as of the model start date and grade to long-term conditions based on historical data at the start of projection year four;

iv. For transactions of derivative instruments associated with fixed income investments, reflect the prescribed assumptions in VM-20 Section 9.F for interest rate swap spreads;

v. For purchases of other fixed income investments, if included in the modeled company investment strategy, set assumed gross asset spreads over U.S. Treasuries in a manner that is consistent with, and results in reasonable relationships to, the prescribed spreads for public non-callable corporate bonds and interest rate swaps.

b. Notwithstanding the above requirements, the stochastic reserve shall be the higher of that produced by the modeled company investment strategy and that produced by substituting an alternative investment strategy in which the fixed income reinvestment assets have the same weighted average life (WAL) as the reinvestment assets in the modeled company investment strategy and are all public non-callable corporate bonds with gross asset spreads, asset default costs, and investment expenses by projection year that are consistent with a credit quality blend of 50% PBR credit rating 6 (A2/A) and 50% PBR credit rating 3 (Aa2/AA).

Policy loans, equities and derivative instruments associated with the execution of a clearly defined hedging strategy are not affected by this requirement.

**Drafting Note:** This limitation is being referred to Life Actuarial (A) Task Force for review.

**VM-31 Changes:**

**Section 3: PBR Actuarial Report Requirements**

1. Life Report – This subsection establishes the Life Report requirements for individual life insurance policies valued under VM-20.

6. Assets – The following information regarding the asset assumptions used by the company in performing a principle-based valuation under VM-20:

r. Modeled Company Investment Strategy and Reinvestment Assumptions – Description of the modeled company investment strategy (before comparison to the alternative investment strategy), including asset reinvestment and disinvestment assumptions, and documentation supporting the appropriateness of the modeled company investment strategy compared to the actual investment policy of the company.

s. Alternative Investment Strategy – Documentation demonstrating compliance with VM-20 Section 7.E.1.g, showing that the modeled reserve is the higher of that produced using the modeled company investment strategy and the alternative investment strategy.

F. VA Report – This subsection establishes the VA Report requirements for variable annuity contracts valued under VM-21.

6. General Account Assets – The following information regarding the general account asset assumptions used by the company in performing a principle-based valuation under VM-21:

a. Modeled Company Investment Strategy and Reinvestment Assumptions – Description of the modeled company investment strategy (before the comparison to the alternative investment strategy) , including asset reinvestment and disinvestment assumptions, and documentation supporting the appropriateness of the modeled company investment strategy compared to the actual investment policy of the company.

b. Alternative Investment Strategy – Documentation demonstrating compliance with VM-21 Section 4.D.4.b showing that the stochastic reserve is the higher of that produced using the modeled company investment strategy and the alternative investment strategy.