

# Preliminary Framework Elements for Fixed Annuity PBR

American Academy of Actuaries Annuity Reserves Work Group (ARWG)

Ben Slutsker, MAAA, FSA  
Chairperson, Annuity Reserves Work Group

John R. Miller, MAAA, FSA  
Vice Chairperson, Annuity Reserves Work Group

Chris Conrad, MAAA, FSA  
Vice Chairperson, Annuity Reserves Work Group



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# ARWG Objective

**Objective:** Propose a new statutory reserve methodology for fixed annuities that uses an actuarial framework to determine reserves based on the level and type of risk inherent in the contract.

## ARWG Pillars of Objective<sup>i</sup>

- 1) Appropriate Reflection of Risk—All else equal, greater risk in *moderately adverse conditions* requires greater statutory reserves, and vice-versa.
- 2) Comprehensive—The statutory reserve accounts for all *material risks covered in the Valuation Manual and inherent in product features and potential management actions* associated with the policies or contracts being valued.
- 3) Consistency Across Products—Statutory reserves between two contracts with *similar features and risks are consistent* given the same anticipated experience, regardless of product type.
- 4) Practicality and Appropriateness—*Balance principles above with an approach that is practical*, auditable, and able to be implemented.



# ARWG Vision and Need

Vision: Provide Academy framework on principle-based reserve (PBR) methodology for fixed annuity products and promote consistency with existing PBR frameworks.

## How ARWG Plans to Accomplish Vision

- a) Propose a PBR Approach—The ARWG plans to propose a CTE70 stochastic reserve calculation.<sup>i</sup>
- b) Develop a Framework Deck—Develop a set of slides laying out various elements of methodology.
- c) Recommend Consistency With VM-21 Where Appropriate—Start with VM-21 methodology.

## Why Fixed Annuity PBR now?

- Flexible Methodology—As new products emerge introducing greater optionality and reinvestment risk, there is greater need for a reserve methodology that appropriately captures the risks in these products.
- Extend Existing PBR Framework—Seek consistency between fixed annuities and life/variable annuities (VM-20/VM-21).

*(i) The ARWG only proposes a PBR modeled reserve and will not include any formulaic or prescriptive floors in its proposal*



# Preliminary Timeline

Fall 2019–Spring 2020

- Develop proposed fixed annuity PBR framework deck
- Begin initial modeling sensitivities for generic FIA w/guarantee

Summer 2020

- ARWG to present framework deck proposal to LATF

Fall 2020

- Seek LATF endorsement of PBR framework deck (w/feedback addressed)
- Valuation Manual language drafting efforts

Spring 2021

- Begin industry field testing using draft (specifics TBD)

Spring 2022

- Target adoption of fixed annuity PBR (potentially VM-22)
- Target 1/1/2023 effective date (monitor as progress develops)



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# ARWG Key Topics

## 1) Product Scope

- **Question:** Apply PBR to both deferred annuity and payout annuity contracts?
- **VM-20/VM-21 Treatment:** VM-20 applies PBR to all individual life products (including an exclusion test) and VM-21 applies PBR to all variable annuity products.
- **ARWG Perspective:** Recommend applying the PBR framework to both deferred and payout contracts. Not applying to immediate annuities allows companies to avoid principle-based reserves and creates possible advantages for some products over others, even if they share the same risks. That said, the recommendation is to hold off applying to Guaranteed Investment Contracts (GICs), funding agreements, and stable value contracts for the first round of fixed annuity PBR and revisit these at a later point in time.

## 2) Exclusion Test Methodology

- **Question:** Allow for exclusion test on new business that follows a similar framework to the VM-20?
- **VM-20/VM-21 Treatment:** VM-20 uses an exclusion test and VM-21 uses an Alternative Methodology.
- **ARWG Perspective:** Recommend following an exclusion test similar to the framework outlined in VM-20, which includes following a stochastic exclusion ratio test or certification method test. Products that pass the exclusion test are deemed to have lower levels of market risk and policyholder optionality risk and, therefore, may elect to use the pre-PBR Commissioners' Annuity Reserve Valuation Method (CARVM) reserve standards (i.e., AG33, current VM-22, AG35, etc.).



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# ARWG Key Topics

## 3) Asset Reinvestment Assumptions

- **Question:** What assumptions should be used for reinvestment strategy?
- **VM-20/VM-21 Treatment:** Use fixed-income reinvestment limits of 50% A / 50% AA and prescribed defaults and reinvestment spreads for fixed-income general account assets.
- **ARWG Perspective:**
  - General account investment risk has a proportionately large impact on fixed annuity modeled reserves relative to other risks, whereas this may not necessarily be the case to the same extent for variable annuities and life insurance (mortality-dependent).
  - If requiring prescribed default/reinvestment spread assumptions, then given the emphasis on general account spread for fixed annuity products, we suggest revisiting the reinvestment 50% AA / 50% A fixed-income guardrail, which does not reflect industry experience.
  - Propose same default/reinvestment spread assumptions as VM-21 but instead use a reinvestment consistent with the current VM-22 credit quality percentage allocation of 5% Treasury, 15% AA, 40% A, 40% BBB.<sup>i</sup>
  - This credit quality mix is already used in the current fixed annuity valuation requirements and is more representative of average industry investment portfolio holdings → Eventually consider updating allocations based on more recent industry experience.



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*(i) Changes to other VM sections are beyond the scope of this effort, but to achieve consistency across the Valuation Manual (i.e., life, variable annuities), VM-20 and VM-21 may also warrant review for considering similar modifications.*

# ARWG Key Topics

## 4) Aggregation

- **Question:** Permit aggregation across various fixed annuity and payout contracts?
- **VM-20/VM-21 Treatment:** VM-21 permits aggregation across contracts; VM-20 permits aggregation within term vs. ULSG vs. other buckets.
- **ARWG Perspective:** Aggregate across fixed annuity contracts, whether payouts or deferred, based on a set of outlined principles (including whether policies are part of the same integrated risk management system, managed/administered together, same or similar asset portfolios, etc.), but with no pre-defined buckets restricting aggregation.

## 5) Inforce Application

- **Question:** Make fixed annuity PBR retrospective to inforce policies? This includes policies issued not only back to the NAIC Valuation Manual Operative Date (1/1/2017), but also to pre-2017-issued contracts.
- **VM-20/VM-21 Treatment:** VM-21 applies to inforce and VM-20 applies only to business issued after the implementation date (1/1/2017 to 1/1/2020 depending on company election).
- **ARWG Perspective:** Still need to investigate further before forming recommendation, but believe there may be merits to exploring eventual inforce application (consistency across risks and products and more principle-based).



# Questions?

- Questions or comments may be directed to:
- Ian Trepanier  
Life Policy Analyst  
American Academy of Actuaries  
[Trepanier@actuary.org](mailto:Trepanier@actuary.org)

