AMERICAN ACADEMY of ACTUARIES

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April 13, 2023

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

Re: Proposed changes to VM-20 outlined in APF 2023-03 (Part 1)

Dear Chair Hemphill,

The American Academy of Actuaries[1] Life Reserves Work Group ("LRWG") appreciates the opportunity to comment on the proposed changes to VM-20 as outlined in APF 2023-03 (Part 1).

The proposed change to Section 3.B.5.c.ii.4 of VM-20 would apply the secondary guarantee funding ratio[2] ("SG funding ratio") to the expense allowance when determining the NPR amount assuming the secondary guarantee is in effect ("SG NPR") and may result in an increase to this reserve amount. (i.e., when the contract secondary guarantee is not fully funded)

The expense allowance is a provision to reserve[3] that accounts for acquisition expenses incurred by the insurer to issue the business. The expense allowance represents the present value of an approximation of average industry acquisition expenses and provides initial surplus strain relief in the reserves. Rationale provided for applying the SG funding ratio to the expense allowance states that reserve movement should be consistent with funding levels. However, acquisition expenses paid by the issuer are not expected to change based on the level of secondary funding by the policyholder. In addition, the net single premium in the SG NPR is already adjusted by the SG funding ratio, which increases or decreases the reserve relative to funding of the secondary guarantee.

Regarding consistency between the Base NPR and the SG NPR, the proposed change would result in applying a ratio to the expense allowance in both reserve components but not a consistent result for the same set of acquisition expenses:

- Base NPR expense allowance is subject to the "Base funding ratio" which measures current account value to expected account value assuming payment of a level premium and guaranteed charges; and

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 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.
[2] Ratio of actual secondary value to fully funded secondary guarantee values at time t, capped at 1
[3] Expense allowance provisions are applicable for all NPR calculations, including ULSG, Term, Other Life business subject to VM-C and pre-PBR ("legacy") reserve calculations including an unscaled expense allowance in Actuarial Guideline XXXVIII

- APF proposes the SG NPR expense allowance be adjusted by the SG funding ratio

Using a shadow account design product as an example, the SG funding ratio would be the policy's current shadow account value to a fully funded shadow account value. In early years of a shadow account SG contract, the fully funded shadow account value is significantly larger than the expected account value used in the Base funding ratio, which means the SG funding ratio will be significantly smaller than the Base funding ratio and the expense allowances between the two reserve components will be different for the same set of acquisition expenses.

The proposed change may result in expense allowances that vary based on contract funding behavior and even SG type (i.e. shadow versus cumulative premium), both have little relation to the acquisition expenses incurred by the issuer and may be unintended consequences of this proposal.

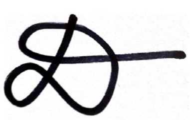
The following quantitative impacts have been estimated for universal life with secondary guarantee ("ULSG") business subject to VM-20:

- **New business:** For a newly issued block of business offering lifetime secondary guarantees the increase to reserves was estimated to be 28% at the end of the first year[4]
- **Existing business[5]:** Estimated increase to reserve for the same block of business above are 22% in year 2 reducing to 9% by year 5 as the expense allowance amortizes and the SG funding ratio grows[4]

In light of the quantitative and qualitative analysis, the LRWG recommends further review of this proposal and its industry impact.

The Life Reserves Work Group appreciates your attention to the issues raised in this letter and looks forward to discussing them further with you. Should you have any questions or comments in response to this letter, please contact Amanda Barry-Moilanen, life policy analyst (barrymoilanen@actuary.org).

Sincerely,



Dylan Strother, MAAA, FSA
Chairperson, Life Reserves Work Group

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Vice Chairperson, Life Reserves Work Group

American Academy of Actuaries

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[4] Impacts stated were developed using a sample model consisting of a mix of business shadow account of varying guarantee lengths (e.g., to a defined age,, lifetime) issued over the last three years. Some of the business also has shorter term specified premium policies in addition to their long-term guarantee.

[5] This includes business issued since 1/1/2020 and for some insurers, business issued as far back as 1/1/2017