



EQUITABLE

DATE: December 14, 2020

TO: Bruce Sartain, Chair, NAIC VM-22 (A) Subgroup

FROM: Aaron Sarfatti, Chief Risk Officer; Steve Tizzoni, Head of Actuarial Regulatory Affairs

SUBJECT: Equitable Comments on Fixed Annuity Principles Based Reserve (PBR) Proposal

Equitable appreciates the opportunity to comment on the Academy Annuity Reserve Working Group's (ARWG) proposed Fixed Annuity PBR framework. Below are our views on two key aspects of the framework: (1) reinvestment mix; and (2) aggregation of reserves. The remainder of our views are appropriately captured in the ACLI comment letter.

Reinvestment Mix:

The VM-22 subgroup requested feedback on the reinvestment mix used in the fixed annuity PBR framework. The ARWG recommends use of reinvestment assumptions that are in line with VM-20 and VM-21 but proposes using a reinvestment mix of 5% Treasury, 15% AA, 40% A, and 40% BBB instead of the current 50%/50% blend of A/AA corporate bonds used in VM-20/21.

Equitable believes credit spread limits for both reinvestment and existing investments are central guardrails to assure the integrity of principle-based reserving. Aggregate or portfolio wide credit spread caps are necessary to ensure the asset portfolio reserve aligns with market pricing for interest-sensitive liabilities and hence ensures balance sheet resilience. Individual security credit spread caps ensure individual assets at high risk of impairment reflect appropriate default loss expectations, although may not be necessary in the presence of prudent portfolio-wide spread caps.

Equitable supports the use of a VM-22 credit quality mix as the aggregate credit spread cap for reinvestment assets as proposed by the ARWG. 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.

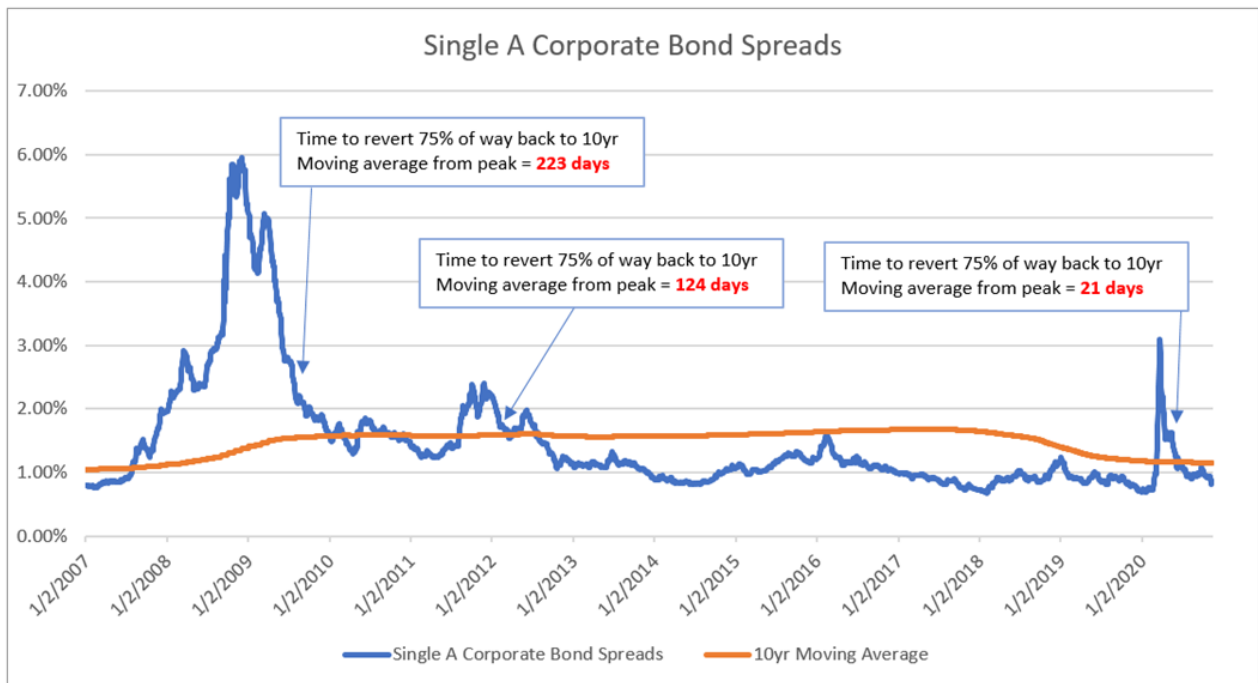
In addition to applying the VM-22 based credit spread cap to reinvestment assets, Equitable supports application of such a cap to *existing* assets. Such a limit would ensure reserves do not rely on excessive amounts of credit spread in excess of industry investment and pricing practices. A credit spread cap applied at the individual security level could also be considered to ensure appropriate default loss expectations are used for assets at high risk of impairment. We think an appropriate level for such a cap would be the lower limit of investment grade credit, approximately BBB.

In addition to extending the scope of credit spread caps within the VM-22 framework, Equitable believes the ARWG should consider shortening the proposed four-year period over which current credit spreads grade to long term spreads to no longer than one year. In practice, we see credit spreads reverting to long term averages significantly faster than four years. In the event of elevated credits, such as in the 2008-2009 financial crisis or the 2020 COVID-19 crisis, we do not believe reserves should reflect benefits of historically wide spreads on assets that the company *does not yet own*. It is reasonable for reserves to

reflect a benefit from such elevated spreads *once the assets are purchased and on the company's balance sheet*.

As an example, consider the March 2020 valuation date. Spreads were extremely elevated at that time, and, under a four-year grading construct, a company would be required to reflect elevated spreads in its reinvestments for the next three years -- a significant reserve benefit as of March 2020. Instead, over the next few months, spreads quickly compressed towards the long-term average, and by June 2020, most of the reserve reduction from elevated spreads at the March 2020 valuation date had reversed without any offsetting benefit to asset book values. This example illustrates why Equitable supports a shorter time horizon for grading to occur (no more than 1 year).

The graph below shows the Barclay's A-rated corporate bond spreads over the past 14 years. The chart demonstrates the swift mean reversion of spreads towards the 10-year moving average corporate spread following each peak. We quantified this pattern by looking at the time for spreads to revert 75% of the way back to the 10yr moving average following each peak in spreads and in each case found that 75% mean reversion occurred within 1 calendar year.



Aggregation of Reserves:

The ARWG proposal allows aggregation of reserves if certain aggregation principles are met (i.e. aggregating policies that have similar risk management strategies, disallowing aggregation for policies that are administered or managed separately, etc.).

Equitable broadly supports the concept of aggregation in reserving, as the aggregation of risk is at the core of the insurance industry. The key risk of including aggregation within reserving is the risk that the projected profits on profitable contracts/product lines are not realized over time and therefore are not available to supplement reserves for in-the-money contracts/product lines. As such, the risk of aggregation equates to the risk that economic and policyholder behavior assumptions on profitable product lines are not realized.

Equitable believes the present governance over aggregation, principally through denying aggregation across major liability types, does not align with the ultimate concern about actuarial risk and is at best a crude guardrail. Equitable recommends a two-fold governance mechanism consisting of:

- a) Governance over assumptions via mechanisms such as the Standard Projection Amount
- b) Disclosure of total aggregation benefits utilized in VM-22 PBR report

Equitable believes this tandem is the best way to govern policyholder behavior risk because it (a) directly guardrails key assumptions for both positive reserve (“in-the-money”) and profitable/negative reserve (“out-of-the-money”) business and (b) alerts regulators to situations where company capital may not be sufficient to withstand material deviations from the failure to realize projected profits

Conclusion:

Equitable appreciates the opportunity to comment on the ARWG’s VM-22 proposal and we look forward to working with the ARWG and regulators to develop an appropriate principle based reserving framework for fixed annuities. We are available to discuss our comments further as desired.

Sincerely,



Aaron Sarfatti, Chief Risk Officer



Stephen M. Tizzoni, FSA, MAAA
Stephen Tizzoni, Head of Actuarial Regulatory Affairs