

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: VM-21 Scenario Consistency Update**Check (applicable entity):**

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue:

This agenda item provides a revision to *Statement of Statutory Accounting Principles (SSAP) No. 108—Derivatives Hedging Variable Annuity Guarantees* (SSAP No. 108) to ensure consistency with the Valuation Manual. This agenda item was developed in response to comments from an actuarial firm identifying an existing reference in SSAP No. 108 to the standard scenario in *VM-21: Requirements for Principle-Based Reserves for Variable Annuities* (VM-21). The Life Actuarial (A) Task Force NAIC staff support confirmed that the reference to the standard scenario has been deleted from VM-21.

VM-21 previously applied the standard scenario to all contracts in scope to generate the standard scenario amount. Revisions to VM-21 following the adoption of the Variable Annuity Framework resulted in the elimination of the standard scenario amount. Instead, VM-21 uses the prescribed projections amount, based on either the Company Specific Market Path (CSMP) or Conditional Tail Expectations (CTE) with Prescribed Assumptions (CTEPA). The CSMP and the CTEPA use random sets of scenarios to generate a CTE70 (adjusted) amount. This agenda item proposes using the VM-21 permitted approach that produces the CSMP or CTEPA scenario reserve closest to the CTE70 (adjusted) as the replacement for the standard scenario when determining the Macaulay duration in paragraph 14 of SSAP No. 108.

Existing Authoritative Literature:

SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees provides the following (bolding added for emphasis)

13. Fair value fluctuations in the measurement of outstanding (non-expired) derivatives within a highly effective hedging strategy shall be reflected as follows:
 - a. Fair value fluctuations in the hedging instruments attributable to the hedged risk that offset the current period change in the designated portion of the VM-21 reserve liability⁷ shall be recognized as a realized⁸ gain or loss.

⁷ Hedge effectiveness is determined by comparing fair value fluctuations between the hedging instruments and the hedged item. However, in determining recognition in the financial statements, the fair value fluctuation of the hedging instruments is compared to the change in the reported value of the designated portion of the VM-21 liability. The designated portion of the VM-21 liability is not reported at fair value in the statutory financial statements, as such, the offset reported as realized gains and losses is the portion of the fair value change in hedging instruments offset by the change in the reported value of the designated portion of the VM-21 reserve. In accordance with the documented hedging strategy, reporting entities shall compare the fair value fluctuations to the change in the designated portion of the reserve liability, after considering recognized derivative returns (including recognized derivative income), when determining the recognition of fair value fluctuations.

⁸ Recognizing the fair value change for open derivative positions that offset the VM-21 change as a realized gain/loss (instead of an unrealized gain or loss) directly offsets the VM-21 reserve change in the income statement.

- b. Fair value fluctuations in the hedging instruments attributable to the hedged risk⁹ that do not offset the current period change in the designated portion of the VM-21 reserve liability shall be recognized as deferred assets (admitted) and deferred liabilities. The ability to recognize a deferred asset and deferred liability is limited to only the portion of the fair value fluctuation in the hedging instruments that is attributed to the hedged risk and does not immediately offset changes in the designated portion of the VM-21 reserve liability.

(Drafting Note subparagraphs 13.c. through 13.e. omitted to conserve space.)

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows **based on the VM-21 Standard Scenario**, but shall not exceed a period of 10 years.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group: None

Convergence with International Financial Reporting Standards (IFRS): Not applicable.

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 108, paragraph 14 as illustrated below. The revision will ensure consistency with VM-21 as it no longer references the standard scenario. With exposure, it is recommended that the Life Actuarial (A) Task Force receive notice of the exposure as part of the coordination process.

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 ~~Standard Scenario~~ adjusted run scenario that produces the scenario reserve closest to conditional tail expectation (CTE) 70 (adjusted), but shall not exceed a period of 10 years. The CTE 70 (adjusted) and the scenario reserve closest to the CTE 70 (adjusted) are determined using the method (company specific market path (CSMP) or conditional tail expectations (CTE) with prescribed assumptions (CTEPA)) applied by the reporting entity^{FN} to calculate the prescribed projections amount.

New Footnote:

VM-21 allows a reporting entity to choose whether to use the CSMP method or the CTEPA method. Once the choice is made the company cannot change the method without the approval of the commissioner. For the purpose of determining the SSAP No. 108 amortization timeframe, the company shall apply its current method to determine the adjusted run scenario.

Staff Review Completed by: Robin Marcotte, NAIC Staff - October 2021

Status:

On October 25, 2021, in response to an e-vote to expose, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No.

⁹ The change in fair value of the hedging instruments and hedged item is limited to changes driven by market factors. For example, periodic recognition of a cost owed to acquire the derivative from a counterparty (financing cost) shall not be captured as a change in the derivative instrument's fair value. The fair value of the instrument shall be determined based on the underlying derivative without inclusion of acquisition costs (or other such contractual elements that may exist with the counterparty) that do not change based on the underlying derivative interests or market factors.

108—Derivatives Hedging Variable Annuity Guarantees to ensure consistency with revisions to VM-21, removing references to the standard scenario. The Working Group also provided notice of the exposure to the Life Actuarial (A) Task Force.

On December 11, 2021, Statutory Accounting Principles (E) Working Group exposed revisions, to *SSAP No. 108—Derivatives Hedging Variable Annuity Guarantees*, as illustrated below. The revisions, which incorporate edits proposed from Life Actuarial (A) Task Force representatives, ensure consistency with revisions to VM-21 by removing reference to the standard scenario while adding reference to the conditional tail expectation 70 guidance. This agenda item has a shortened exposure period, ending Jan. 14, 2022, so that the Working Group may consider adoption for year-end 2021 reporting.

Exposed Revisions to SSAP No. 108

14. Deferred assets and deferred liabilities recognized under paragraph 13.b. shall be amortized using a straight-line method into realized gains or realized losses over a finite amortization period. The amortization timeframe shall equal the Macaulay duration of the guarantee benefit cash flows based on the VM-21 Standard ~~Scenario~~[Projection \(new FN\)](#), but shall not exceed a period of 10 years.

New Footnote:

[The VM-21 Standard Projection calculation shall be the prescribed assumption run for the scenario that produces the scenario reserve closest to conditional tail expectation \(CTE\) 70 \(adjusted\) and a discount rate equal to the valuation interest rate specified by the Standard Valuation Law for annuities valued on an issue year basis, using Plan Type A and a Guarantee Duration greater than 10 years but not more than 20 years. The VM-21 Standard Projection with prescribed assumption run is determined using the method \(company specific market path \(CSMP\) or conditional tail expectations \(CTE\) with prescribed assumptions \(CTEPA\)\) applied by the reporting entity to calculate the prescribed projections amount. For the CSMP method, the economic scenario is Path A, with the guarantee benefit cash flows from the run to calculate Prescribed Amount A. For the CTEPA method, the economic scenario is the scenario that produces the scenario reserve closest to the CTE70 \(Adjusted\) from the stochastic reserve calculation, with the guarantee benefit cash flows from the VM-21 Standard Projection with prescribed assumption run for this economic scenario.](#)

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2021/13.FallNationalMeeting/Exposures/21-18-VM21toSSAP108Update.docx>