November 19, 2021

Mr. Bruce Sartain
Chair, NAIC Valuation Manual (VM)-22 (A) Subgroup (Subgroup)

Re: ACLI Comments on ARCWG VM-22 Framework Draft Proposal

Dear Mr. Sartain:

The American Council of Life Insurers (ACLI) appreciates the opportunity to provide comments on the American Academy of Actuaries (the Academy) Annuity Reserves and Capital Work Group VM-22 Framework Exposure.

ACLI appreciates all the hard work of the Subgroup and ARCWG in development of this draft. We believe the framework is an excellent first step towards principles-based requirements for fixed annuities. We look forward to working with the Subgroup and ARCWG in further development of the framework, and on notable areas that were not addressed in this first exposure.

ACLI supports the continued development of principles-based reserving. We believe that this development is the natural progression of measurement of underlying risks in company portfolios. PBR enables better measurement of complex guarantees and other risks and reflects the underlying experience of the block, while maintaining appropriate flexibility consistent with the complexity of the risks being measured.

Our comments are broken into two sections: priority areas for requested comment and comments on individual sections of the VM-22. You will also find our comments in the accompanying Word document.

VM-22 Exposure Comments and Priorities Comments:

- Standard Projection Amount (SPA): If any reserve method includes a SPA, the ACLI supports making the SPA a nonbinding disclosure item across the applicable VM chapters. We appreciate the use of the SPA to help identify outlier assumptions; however, we note that having one-size-fits-all prescribed assumptions is extremely challenging due to the variety of designs in the market. Further, a binding floor introduces non-economic considerations to the reserve that do not align with management of the portfolio. Consistent with our feedback regarding the variable annuity framework, we are concerned
about the possibility of this approach producing false positives and false negatives regarding outliers.

- Reserving Categories: We believe aggregation should be consistent with management of liabilities and assets throughout the lifecycle of the portfolio and VM-22 should allow for companies to designate aggregation of blocks consistent with their operational and investment management. Multiple categories and other aggregation limits could create disconnects with the actual management and asset portfolio of the company. Further, a greater level of aggregation encourages well-diversified portfolios and sound-risk management.

Were multiple reserve categories to be defined, we would support a principles-based categorization to accommodating innovation in the market. Further, we suggest an “at issue” approach to better align with management of the block and to avoid any disconnects in the level of the reserve were a block to switch between categories. Additionally, certain additional disclosures may not be applicable under this approach, such as those related to investment strategy when the company is not modeling it; we would suggest limiting the disclosures and reporting to items actually used in the calculation. For Option 1, we suggest deleting item #6 to be consistent with VM-21 or at least need to exclude payment streams from VAs which are scoped into VM-21.

- Model Segments (Section 3.E): Consistent with our comments on reserving categories, we believe the model segments should appropriately align with the internal management framework of companies to appropriately reflect inherent offsets in risks, which is in the spirit of a principle-based framework. We do not believe restrictive requirements around segments serves to solve any known problems, as two disjoint scenarios cannot occur at the same time within a company’s portfolio. We suggest consistency of this text with the existing VM-20 Section 7.A.1.b.

- Allocation (Section 12): We believe discussion of allocation of aggregate reserves should be analyzed as part of the field study.

- VM-21 vs. VM-22 Distinction (VM Section II edits): Consistent with the exposed framework, we support the continued inclusion of RILA and RILA-like products within VM-21. We are appreciative of the key considerations outlined in Valuation Manual Section II, Reserve Requirements Subsection 2.E and support further clarification of the intent of this text for greater clarity on the applicable guidance.

- Exclusion Test: ACLI is supportive of the exclusion test, however, we believe there are areas that could be clarified. We think there could be greater clarity regarding how exactly the exclusion test should be executed. For the Deterministic Certification Option, we request the text to be clarified regarding what business can use this option due to potential confusion in the current text; it would be clearer if the Guidance Note after 7.E.2 were moved to the beginning of Section 7.E to clarify what type of business falls into this category.
We do not believe in the necessity of including longevity risk within the scope of the exclusion test since we are not attempting to model longevity/mortality stochastically. We recommend striking longevity risk related components of this section throughout, including in 7.B and 7.C.1, and deleting the Drafting Note after 7.E.1.d.

Please find additional comments below in Section 7.

Specific feedback on sections:

- **Section 1**
  - A (Purpose): The proposal suggests VM-22 is not operative until 1/1/2024, which contradicts Section 13 and existing requirements. We would suggest rewording this to clarify that Section 13 is effective after 12/31/2017. Further, we would suggest consistency in labeling of dates (either all text or all numeric).
  - A (Relationship to RBC Requirements): The VM-21 guidance note was not included in VM-22; however, we believe it would be appropriate to retain and reword to say, “products that calculate a stochastic reserve”, since the relationship to RBC would likely be maintained.
  - B (Principles): We would support consistent application of principles across all chapters as currently VM-20 does not have a like-set of principles. We believe this could involve a broader discussion of the assorted product requirements in the VM. As a shorter-term fix, we would recommend generalizing the principles where appropriate and moving these to "Section 1. Introduction" or "VM-01" and equally applying to VM-20.
  - B (Principle 2): We support this principle but note that later sections appear to contradict this principle. For example, the statement "The analysis reflects prudent estimate assumptions for deterministic variables and is performed in aggregate (subject to limitations related to contractual provisions) to allow the natural offset of risks within a given scenario." contradicts with the introduction of additional reserve categories and other limitations (such as model segment restrictions).
  - B (Principle 3): We suggest deleting the sentence "Generally, assumptions are..." since it does not provide guidance. We also suggest tightening the remainder of the text for clarity.
  - B (Principle 5): We recommend deleting the third sentence (starting with “Therefore, the use of assumptions...”) because this lacks historical context and is covered by the final sentence.
  - C (Risks Reflected): Consistent with our comments on 1.B, we would support consistent application of risks reflected across all chapters, rather than embedding the language in each chapter. Were this to be retained in VM-22, we would suggest maintaining consistency with VM-21 to avoid any confusion.
  - C.2.c.i: We recommend removing the bullet “Risks modeled in the company’s risk assessment processes that are related to the contracts, as described above” as this is unclear and probably extraneous.
  - C.3: We recommend removing this section. With the specific RBC language removed, the section loses meaning: "a" is unnecessary and "b" is redundant with
other sections of the VM which allow for materiality considerations (language in VM-20 is likely better for this purpose and should be used consistently).

- C.4.b.iv: We recommend removing the bullet “Significant future reserve increases as an unfavorable scenario is realized” as this is extraneous.
- C.4.c (General business risks): List could be expanded to included operational risk and litigation risk.
- D (Specific definitions for VM-22): It seems the definitions included in this section are largely only used for the purpose of establishing the Scope in Section 2. Since this is intended to be a principles-based methodology, recommend a strong definition of “Fixed Annuity” instead of specific products underneath this business. The first paragraph in A. Scope seems to provide this with specific references which are out of scope. If changing the scope section, we would suggest deleting the various product definitions if not used elsewhere; if these definitions are potentially applied beyond VM-22, we would suggest moving any necessary definitions to VM-01.
- D (Deferred Income Annuity (DIA) definition/Single Premium Immediate Annuity (SPIA) definition): Suggest aligning the cut off to 13 months for alignment consistent with Actuarial Guideline IX, rather than the 1 year that currently is in the VM-22 draft.
- D (Fixed Indexed Annuity (FIA) definition): Is “typically” intended to be a requirement in the definition? That is, to qualify as FIA does there need to be guaranteed principle?
- D (Index Parameter definition): We would suggest adding performance trigger to the list, along with other potential crediting methods; alternatively, the definition could specify that the crediting methods listed are examples only.
- D (Longevity Reinsurance definition): The definition states that “Agreements which are not treated as reinsurance under Statement of Statutory Accounting Principles (SSAP) No. 61 R are not included in this definition”. Why is this the case and does this imply that longevity swaps are not within the scope of VM-22? Recommend adding to the out-of-scope list in “2.A. Scope” if that is the case. Clarification would also be helpful on what guidance should be used for these agreements if out of scope for VM-22. Further, we would suggest removing “typically” from the definition.
- D (Modified Guaranteed Annuity): We recommend editing the definition as follows “A type of market-value adjusted annuity contract where the underlying assets are most commonly held in an insurance company separate account…”
- D (Pension Risk Transfer (PRT) Annuity definition): Is “typically” intended to be a requirement in the definition? That is, to qualify as PRT must the insurance company have the asset risk? Consistent with the comment on Longevity Reinsurance, it would be helpful to clarify where a longevity swap contract falls within these definitions. Notably, index-based longevity swaps should be out of scope as they do not meet definition of “annuity contract” in SSAP 50. It should also be made explicit that PRT contracts can include lump sum benefits, death benefits and cash balance benefits as well.
- D (Registered Index-Linked Annuity (RILA)): It is unclear to us why RILA is defined in VM-22 when it is being used to exclude the product from VM-22 requirements.
D (Structured Settlement Contracts (SSC)): Suggest striking sentence “Adverse mortality is typically expected for these contracts.” from definition. Additionally, it is possible that there may be non-substandard settlements.

- **Section 2**
  - Consistent with our comment in Section 1, the language around effective date should be clear this only applies to new PBR methodology, and rates in Section 13 have a different effective date.
  - We would support reworking this section to rely on principles, rather than definitions to determine what is in and out of scope. As product innovation continues, a simple list may not appropriately accommodate the applicability of this chapter. However, if such a list is included, then we believe it should align with the full list presented in Section 13.
  - We suggest moving or deleting the sentence “The company may elect to exclude one or more groups of contracts from the stochastic reserve calculation in certain situations, pursuant to the exclusion test requirements defined in Section 3.E of VM-22.” from this section as it does not seem fitting here.

- **Section 3**
  - B: Guidance is needed on how a pre-reinsurance reserve is to be determined.
  - D: The term "Deterministic Certification Option" may be confusing, as there is no "deterministic" reserve, unlike VM-20. We recommend consideration of an alternative term. In addition, we recommend changing the phrasing to "with the exception of groups of contracts for which a company elects the [Deterministic Certification Option], following the requirements of Section 7.E."
  - E.1: Seems to imply that only SPIAs would pass due to the linkage to Section 13. But the reference to interest rates should be broader, if even necessary. Suggest editing as:
    "these groups of contracts may be valued using the methodology and statutory maximum valuation rate pursuant to applicable requirements in VM-A, and VM-C, and with the statutory maximum valuation rate for immediate annuities specified in Section 13."
  - E.2: This section seems to indicate that the grouping of contracts in exclusion testing should be the same as the grouping of contracts for aggregation. This might cause fewer product types to be qualifying for exclusion if the test must be performed at a higher level of aggregation.
  - E (Guidance note beginning “The intention of contracts that pass the stochastic exclusion test…”): We believe this guidance note is unnecessary as the intent of the section is clear, and the wording is possibly confusing.
  - F (Allocation) Either in this item or in Section 12 allocation to contracts not covered by PBR methodology in VM-22 needs to be addressed e.g., carve out because reserves calculated on seriatim formulaic basis.
  - G (Prudent Estimate Assumptions): This sub-section seems more appropriate in Section 4 (or pulled out completely and consolidated within “I. Introduction” or “VM-01” and applied to all PBR methods).
G.2: Suggest replacing "If the results of statistical testing or other testing" with "If the results of the review" to simplify language and avoid possible confusion.

Section 4
- A.1.b (Guidance Note): The purpose of this guidance note is not clear as these charges would be reflected in the cash flows.
- A.2: Suggest editing the first sentence to note scope is FIAs and to avoid confusion regarding the term “investment guideline” as follows: “Index crediting strategies for fixed indexed annuities may be grouped for modeling using an approach that recognizes the investment guidelines and objectives of each index crediting strategy.”
- Given that Section 9 covers hedging, we would suggest considering moving parts of Section 4.A.4 to that section.
- A.4: Suggest rewording "Future hedging program" to “hedging program with future transactions” to avoid ambiguity.
- A.4.b.ii.b): “Any other purpose” in the last sentence seems overly broad and should be narrowed.
- A.4.b.ii.c): Margins are discussed in a different section, so recommend deleting.
- A.4.b.i.c): We believe the company should determine the appropriate margin based on their demonstration of effectiveness. Any guardrails on these undetermined values should be minimal, including as low as 0, subject to the appropriate demonstration of effectiveness. Further, we believe that documentation of effective product management should be contemplated in addition to historical effectiveness.
- A.5: Unclear why Revenue Sharing is considered for non-variable products, can probably delete.
- B.1: Section does not specify what the reserve floor shall be (if any) for contracts without cash surrender value.
- B.3.a We believe that assets held in the separate account with performance not impacting policyholder benefits should be modeled consistent with how the business is managed.
- D.4.b: Request clarification around the meaning of “general account index funds.”
- E.1.b. Suggest deleting “In contrast, for payouts specified at issue, the payout rates modeled should be consistent with those specified in the contract.” as it appears to be covered by E.1.a.
- E.2: Suggest deleting “may” as there appears to be only option.

Section 5: The wording and titling may need to be tightened due to clarify which items apply to assumed and ceded reinsurance in the text.

Section 7
- B.3: We recommend removing "pension risk transfer business" from products scoped out of SET certification method. It is unclear why this business would be treated differently from individually issued business for testing intended to capture interest rate risk.
C.1: As written, the SERT assumes a single premium product given the change of the denominator to the scenario reserve. Alternative product designs (such as longevity swap) could result in unintended results. We recommend maintaining consistency with VM-20 and using a denominator of future benefits (annuity payments, DBs, etc., excluding premium considerations, expenses, etc.).

C.2.d: Clarification is needed around reference to "significantly different risk profiles."

C.3: We request clarification or definition of the term “non-proportional reinsurance.”

C.3.a.iii: We believe subscript “gy” should be “gn.”

D.1.a: Does this statement imply a floor reserve of VM-A and VM-C? VM-20 does require the NPR as the floor of the reserve but as written, VM-22 does not require a floor reserve. Recommend removing 1.a. Same statement with the 2.a statement demonstration. This requirement does not apply to the other permitted tests, which seemed counterintuitive.

- **Section 9**
  - Section 4.A.4 (Modeling of Hedges) has some relationship with this section, we request clarification around the applicability of these two areas of hedge guidance.
  - A.1: We seek clarification of this text: if a company only hedges indices or separates index crediting from other hedges, does this apply, or does it only apply to any other hedging?
  - A.3: The sentence “Prior to reflection in projections, the strategy for future hedge purposes shall be the actual practice of the company for a period of time not less than [6] months.” seems to suggest you would do something other than the actual hedging strategy after [6] months. In this case, what are you assuming for modeling? We suggest clarification of this sentence.
  - D.2: Suggest replacing “indexed” with “fixed” since this would apply to all fixed annuities.

- **Section 10**
  - A.7: We would suggest rewording this section to be considerations rather than posed as questions.
  - D.8: This section states that “contract holder behavior should neither assume that all contract holders act with 100% efficiency in a financially rational manner nor assume that contract holders will always act irrationally.” This text seems to directly contradict Section II. Reserve Requirements 6.H.2 which states “When advantageous, policyholders will commence living benefit payouts if not started yet.” We suggest revising 6.H.2 to align with the text of 10.D.8.
  - C (Sensitivity Testing): Suggest updating bullet to “Other material behavior assumptions if relevant to the risks in the product.”
  - E.2: Suggest replacing “Risk factors that are not scenario tested but” with “Static assumptions that” to improve clarity in the wording.
  - F.1.d (Volatile credit spreads): Suggesting deleting as we are not aware of dynamic credit spreads typically being modeled.
• **Section 11**
  - Specific requirements will require further discussion, particularly what if any industry experience is identified for the SPA. Ideally, updated, and appropriate assumptions should be used for better alignment and to avoid any false positives flagged as an outlier by the SPA.
  - A.4: Termining the segments “mortality (longevity) segments” would be easier to understand than “plus (minus) segments.”
  - B.3.i.c: For PRT an assumption based on a third-party data provider would be better than the industry table to get contract specific mortality assumptions. Is this permitted? The guidance note in A.3 seems to get at this, but it is not clear in B.3.i.c whether this is allowed. This is an important distinction as PRT population can vary from those populations the tables are based upon.
  - B.3.iii The phrase “When little or no experience or information is available on a business segment” is not included, unlike in (i) and (ii) of the same sub-section. It appears to be the intent that this is the only situation in which this would apply, but it would be helpful to make this explicit.

  - C.1: Both plan and industry data should get weighted for business such as PRT. This text says to blend with prescribed tables, but that might not make sense unless additional experience data was unavailable.
  - C.2: Mortality improvement should be consistent with the underlying tables used, so we would suggest this being based on available experience subject to appropriate guardrails.

• **Section 12:** We believe discussion of allocation of aggregate reserves should be analyzed as part of the field study.

• **Section II. Reserve Requirements**
  - We believe a Fixed Annuity PBR Exemption should be incorporated into draft in a manner consistent with the Life PBR Exemption.
  - 6.H.2: This section states that “When advantageous, policyholders will commence living benefit payouts if not started yet.” This text seems to directly contradict VM-22 Section 6.H.2 which states “contract holder behavior should neither assume that all contract holders act with 100% efficiency in a financially rational manner nor assume that contract holders will always act irrationally”. We suggest revising 6.H.2 to align with the text of 10.D.8.

We appreciate the consideration of our comments and look forward to discussing at a future meeting.
Sincerely,

[Signature]

cc: Reggie Mazyck, NAIC