Interpretations of the Emerging Actuarial Issues (E) Working Group

Introduction

The Emerging Actuarial Issues (E) Working Group responds to questions of application, interpretation and clarification with respect to *Actuarial Guideline XXXVIII—The Application of the Valuation of Life Insurance Policies Model Regulation* (AG 38). Following an abbreviated public comment and review period of no less than 7 days, the Working Group will adopt by consensus formal interpretations on issues presented before it. These interpretations will then be reported to the Financial Condition (E) Committee, which, after adopting, will direct the Financial Analysis (E) Working Group to follow the interpretations in performing its reviews of the reserving methodologies under AG 38. These interpretations are not effective until formally adopted by the Financial Condition (E) Committee. In no event shall a consensus opinion of the Working Group supersede or otherwise conflict with AG 38.

Interpretations INT-01 through INT-24 were adopted in 2012, with the exception of INT-21 which was adopted in 2013. Interpretations INT-25 through INT-37 were adopted in 2013. Interpretations INT-38 through INT-41 were adopted in 2014. Interpretation INT-42 and a revision to INT-39 were adopted in 2015. New Interpretations they will be added to this document as they are adopted.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-01

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation,

Section *8D(b)*

Issue / Question

1. The Guideline does not seem to preclude a company from using the Alternative Reserve Methodology for yearend 2012, thus avoiding the Primary Reserve Methodology calculations, even if in prior valuations their total reserve held was not at least as great as the total reserve determined in accordance with the November 1, 2011 Life Actuarial (A) Task Force (LATF) statement. In other words, at yearend 2012 a company can switch to any alternative reserve methodology as long as the total reserve held is at least as great as the total reserve determined in accordance with the November 1, 2011 LATF statement using the required lapses and mortality. Is that a correct interpretation?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Yes. The requirements as written provide for use of either 8D(a)or 8D(b) for the 12/31/12valuation.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-02

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 19, 2012

Date Adopted by Financial Condition (E) Committee

December 20, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation Section 8D(b)

Issue / Question

1. If a company uses the Alternative Reserve Methodology for yearend 2012, can they switch to the Primary Reserve Methodology for future valuations? What, if anything, should be reported in Exhibit 5A-Changes in Basis of Valuation for yearend 2012 or in future years as a result of these AG 38 revisions and any switch to the Primary Reserve Methodology or to the Alternative Reserve Methodology?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. A company, pursuant to the requirements of AG 38, 8D, may switch between the Primary Reserve Methodology and the Alternative Reserve Methodology.

3. For 12/31/12 or subsequent reserve valuations any change to or from the Primary or Alternative reserve methodologies should be reported in Exhibit 5A.

4. The company should check with their domestic state whether approval is required for any subsequent change to or from the Primary or Alternative reserve methodologies for reserves after 12/31/12.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-03

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(b)

Issue / Question

1. The Alternative Reserve Methodology calls for deficiency reserve mortality to be based on the VM-20 deterministic reserve mortality. Since XXX calls for segments to be based on deficiency reserve mortality this could affect segment lengths. However, at least the spirit of AG46, which came out when the 2001 CSO Preferred Risk tables came out, seems to allow for segments to continue to be based on the mortality table in use when the policy was issued. Does AG46 apply here and thus the original mortality basis for the segment lengths can continue to be used?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. The original mortality basis for determining the segment length can continue to be used. 8D is not intended to be more restrictive in determination of segments.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-04: Section 8D

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38-The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D

Issue / Question

1. The Guideline states "The requirements of this Section 8D apply to a company on December 31, 2012, and on any subsequent valuation date if (1) on the applicable date, the in force face amount (direct plus assumed) of universal life insurance to which this Section 8D would otherwise apply exceeds 2% of the company's face amount of individual permanent life insurance in force…". Does the referenced individual permanent life insurance exclude term insurance?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Yes. Term is excluded.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-05

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 19, 2012

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December 20, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D

Issue / Question

1. Subsection 8Da states that the Primary Reserve is determined by adding any excess of (2) over (1), where (1) is the reserve according to the methodology and assumptions used to calculate the reserves reported as of December 31, 2011. In the following three scenarios, what is the basis for the determination of (1)? Assume that scenarios 1 and 2 involve universal life with secondary guarantees (ULSG) policies issued between July 1, 2005 and December 31, 2006, with a higher set of cost of insurance (COI) charges being triggered if the shadow account value ever becomes 0 after issue:

   a. Issue 1) Reserves have always been calculated using the wrong methodology for determining the ratio in the fourth step of Section 8B. In applying Section 8D, would the reserves for 8Da1 be based on the correct methodology or on the methodology actually used by the company for year-end 2011?

   b. Issue 2) A policy has a negative account value but has not lapsed due to the secondary guarantee. The shadow account value eventually drops to 0 and then becomes negative, and the policyholder pays a premium during the grace period intended on keeping the policy in force. The company invokes the higher secondary guarantee charges to calculate the shadow account value, but the policyholder argues that the lower shadow account COI charges apply due to the premium being paid during the state required grace period; i.e. that during the grace period the policyholder has the opportunity to pay a premium based on the lower COI charges rather than based on the much higher set of COI charges. This is litigated, and a ruling is made that the higher COI rates cannot be charged unless the shadow account value has not been positive for a period of time greater than the grace period. Based on this ruling, the assumption in the AG38 calculation that the higher set of COI charges would be triggered at the end of the first policy year would not be valid. Would the reserves for 8Da1 continue to be based on the assumption that the higher COI charges would be triggered after the first policy year, or would they be modified to reflect the lower COI charges?

   c. Issue 3) Policies with multiple sets of COI charges have only been issued in 2012. What is the basis for the value of (1)?

2. Issue 1): The reserves determined by the company under 8D(a)(1) are intended to be consistent with the methodology used by the company for the 12/31/2011 valuation. If a calculation error has been made in applying the 2011 methodology, this error should not be repeated in applying this methodology for the 2012 year-end valuation.

3. Issue 2): Where a valid court decision has interpreted the provisions of a policy, those interpretations should be reflected in future reserve calculations. In effect, the court ruled that the company made a mistake in applying certain policy provisions. Therefore, the 2012 reserve calculations should incorporate the correct view of the affected policies' provisions as determined by the court. As in 1) above, any error in the 2011 reserve calculations due to this company mistake should not be perpetuated in the 2012 reserve calculations.

4. Issue 3): In this case, the value of (1) would be based on the company's methodology for reserving these policies for 2012 quarterly reporting.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-06

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(b)

Issue / Question

1. Is the report documenting the special 2012 sensitivity test described at the end of Section 8D required to be a stand-alone document or can it be included in the required Section 8D Actuarial Memorandum?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Considering the special nature of the 2012 sensitivity test, the documentation should be contained either in a stand-alone document or included as a separate appendix in the Actuarial Memorandum

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-07

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference
Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(b)

Issue / Question

1. If all of a company's universal life with secondary guarantees (ULSG) policies subject to Section 8D are the same identical policies that are subject to Section 8C, are they still required to perform the separate Section 8C stand-alone asset adequacy analysis or does the Section 8D Primary Reserve Methodology calculation suffice?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Such policies are still required to perform the separate Section 8C stand-alone asset adequacy analysis. Section 8D, second paragraph, clarifies that Section 8D is "in addition to any testing that may be required under Section 8C."

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-08

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(a)

Issue / Question

1. For companies using the Primary Reserve Methodology, is it expected that the full deterministic reserve calculations will be performed every quarter or just annually?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. This methodology would be used at least annually, with appropriate approximations used as permitted pursuant to quarterly statutory reporting requirements.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-09

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(a)

Issue / Question

1. If the deterministic reserve "wins" for the Primary Reserve Methodology calculation, what impact should that have on tax reserves?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. This question involves determination of values under the requirements of the Internal Revenue Code. The NAIC has no comment on how those values should be determined.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-10

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(a)(2)

Issue / Question

1. In relation to the Valuation Manual, Item 2. under the Primary Reserve Methodology section references "…or in any version subsequently adopted by the NAIC…." Please clarify exactly what constitutes "adopted by the NAIC." Does it have to be adopted by Executive/Plenary or just the A Committee or just Life Actuarial (A) Task Force (LATF)? "version" includes amendments that have been adopted, correct?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Adopted by the NAIC means the Valuation Manual and any amendments adopted through Executive & Plenary as of the 7/1 preceding the year-end valuation date.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12 -11

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 19, 2012

Date Adopted by Financial Condition (E) Committee

December 20, 2012

Reference
Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation

Issue / Question

1. My question is on section 8E, regarding when a product would fall under method 1 or method 2. If you have a shadow account product that has either a single set of charges, or multiple sets of charges, and the product meets the crediting rate limitations defined in method 1, is there anything that could cause the product to be deemed to be subject to method 2? To put it another way, when I read section 8E, it seems that any shadow account product meeting the interest crediting limits would fall under method 1. This is because all shadow accounts have either a single set of charges or multiple sets of charges, so all shadow account products that meet the interest crediting limitation would fall under policy design 1 or policy design 3. Is this a correct interpretation, or if not, why?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. This interpretation is not completely correct. In drafting the revisions to AG 38, regulators were aware of the possibility that all existing and future product designs might not fit the three generic product designs noted in AG 38, independent of the crediting rate limitation. Method II was intended to provide a default reserve methodology for these other product designs, together with the more generic product designs containing interest crediting guarantees higher than the company-selected interest index plus 3 percent. The considerations in satisfying the actuarial opinion requirements contained in Section 8E should enable the opining actuary to determine the appropriate reserving methodology for a particular universal life with secondary guarantees (ULSG) product design.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-12

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D(b)

Issue / Question

1. Section 8D(b), Alternate Methodology, requires the company to determine its deficiency reserve under Model 830 using mortality and lapse assumptions according to the same requirements for determining the deterministic reserve in the Valuation Manual. Does this require the company to determine its Triple-X segments (under the segmentation method) using the qx and lapse rates of the VM, or simply use these qx and lapse rates in calculating the deficiency reserve once the segments are determined using the company's current approach for determining such segments?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. The original mortality basis for determining the segment length can continue to be used. 8D is not intended to be more restrictive in determination of segments.

Note: This response is similar to that for question Actuarial INT 12-3.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-13

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 19, 2012

Date Adopted by Financial Condition (E) Committee

December 20, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation

1. Issue / Question Given all of the focus that the Guideline places on what premiums to use for these universal life with secondary guarantees (ULSG) reserve calculations, we are having unexpected difficulty finding published guidance on what premiums to assume in the deterministic reserve calculations for the Primary Reserve Methodology. Does such guidance exist and if so, where can we find it?

2. This question specifically asks for published guidance, but if none exists perhaps, the Working Group could provide such guidance or at least common practices/approaches they are aware of. Guidance is needed to create consistency amongst how companies are approaching this step of the calculation.

Interpretation of Emerging Actuarial Issues (E) Working Group

3. For 8D(a)(2) reserve calculations, the company should use the expected premium to be paid by the policyholder, determined either policy by policy or by appropriate policy groupings. The Valuation Manual adopted by the A Committee on 8/17/12 provides requirements regarding premiums for the deterministic reserve calculation. Such requirements include those in Section 4(A), Section 7(B), and Sections 9(A) and 9(D).

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-14

Date Adopted by Emerging Actuarial Issues (E) Working Group

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December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E

Issue / Question

1. In the case of a Method I type product that is currently being sold and will continue to be sold unmodified after 12/31/12, the company would have to do a standalone asset adequacy analysis under Section 8C for issues 1/1/07 through 12/31/12 but they would not have to do a standalone asset adequacy analysis for issues after 12/31/12 even though it is the same product. Correct?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Yes. It is a correct interpretation that the stand-alone asset adequacy analysis in 8C does not include policies issued after 12/31/12.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-15

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E(II)

Issue / Question

1. The minimum schedule of premiums required to be identified/tested for in Method II is something that is expected to be needed to be done separately for every age/sex cell, correct?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Yes. The schedule of minimum gross premiums should be based on all appropriate attributes unique to the policy being valued.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-16

Date Adopted by Emerging Actuarial Issues (E) Working Group

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Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference
Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E

Issue / Question

1. If all of a company's currently approved universal life with secondary guarantees (ULSG) policy forms fall under the same Method I policy design, pass the Index Test, and meet the minimum premium requirements, can a single Actuarial Opinion and a single Company Representation be submitted that lists each policy form or does a separate Actuarial Opinion and a separate Company Representation need to be submitted for each form?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. This is up to the state of domicile. Some groupings may make sense but any special qualification or language needed should result in a separate opinion and representation.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-17

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference
Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E(II)

Issue / Question

1. Is the greatest deficiency reserve test to be performed on a seriatim or product level basis? What if we see mixed results (For example, 70% pattern 1 and 30% pattern 2)

Interpretation of Emerging Actuarial Issues (E) Working Group

2. The test should be performed on a seriatim basis, except to the extent it may be practical to group policies with identical attributes. It is possible that several combination premium patterns will be identified as having broad applicability. Regardless, each policy should assume a premium pattern that produces the greatest deficiency reserve as of the issue date consistent with good faith testing and review.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-18

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference
Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E(II)

Issue / Question

1. For the combination premium patterns, what does it mean "...to have access to better charges and credits...."? Can this be ignored it if the product only has one set of charges?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Better charges and credits can be understood as lower charges and/or higher credits that may be triggered based on the magnitude of the premium paid, the shadow account or other measures generally dependent on policyholder behavior. For example, a higher interest rate might apply to amounts above or below some defined premium dollar limit in particular policy years or based simply on the level of the shadow account. Higher or lower premium payments could lead directly to the most favorable interest rate (or weighted average interest rate) accessible within product design constraints. Better charges and credits would generally lead to lower minimum gross premiums and potentially greater deficiency reserves. For purposes of this question this requirement cannot be ignored, particularly if there are multiple sets of credits in addition to the assumed single set of charges.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-19

Date Adopted by Emerging Actuarial Issues (E) Working Group

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Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E(II)

Issue / Question

1. When testing combination premium patterns, do premium patterns that break segments need to be considered?

Interpretation of Emerging Actuarial Issues (E) Working Group

2. It is not necessary to reverse engineer premium patterns solely to create unfavorable segment breaks. However, segment breaks that result from premium patterns consistent with the applicability of favorable charges and credits must be considered.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-20

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 20, 2012

Date Adopted by Financial Condition (E) Committee

December 1, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E(II)

Issue / Question

1. Do patterns with dump-in premiums need to be tested? If so, how should the dump-in premium be reflected in the determination of the uniform percentage (i.e., do you include the dump-in premium in determining the k percentage)

Interpretation of Emerging Actuarial Issues (E) Working Group

2. Premium patterns that involve dump-in premiums must be considered, and testing may be appropriate. In the absence of more definitive guidance, the uniform percentage should be determined in accordance with Actuarial Guideline 21.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-21

Date Adopted by Emerging Actuarial Issues (E) Working Group:

January 30, 2013

Date Adopted by Financial Condition (E) Committee:

February 20, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D (a)(2a)

Issue / Question:

Should the VM-20 deterministic reserve starting asset requirement related to the 2% collar be applied before or after the Primary Reserve Methodology caps on starting and reinvestment assets are applied?

Interpretation of Emerging Actuarial Issues Working Group:

Subsection a.2.a) (I) of Section 8D requires the determination of one of two portfolios of existing assets to support the initial reserve estimate for the block. Once this initial asset portfolio is determined, the deterministic gross premium reserve is determined using as the discount rates the net investment returns generated by the future projected cash flows calculated using the selected initial portfolio and future net reinvestment rates established according to subsection a.2.a) (II) of Section 8D.

If the resulting reserve falls within the +/- 2% collar (referenced in VM-20) relative to the initial reserve estimate (and corresponding level of initial assets), the calculated reserve is the final reserve. If the calculated reserve breaches the +/- 2% collar, the actuary must either provide a detailed rationale as to why the calculated reserve is appropriate or redo the reserve calculation assuming revised initial reserve and asset levels.

In performing the additional reserve calculation(s), use the same asset portfolio (adjusted upward or downward as below based on the results of the deterministic reserve calculation), either that of subsection a.2.a) (I) (i) or a.2.a) (I) (ii), as chosen for the initial reserve calculation.

If the initial or subsequently determined reserve is greater than the prior reserve estimate and the asset portfolio used in the deterministic reserve calculation is:

I. as described in subsection a.2.a)(I)(i), then the prior asset portfolio shall be adjusted upward using assets as described in subsection a.2.a)(I)(i) to the extent such assets remain available in the company's portfolio after which such assets shall be adjusted upward as needed using assets as described in subsection a.2.a)(I)(ii). The recommended method for adjusting the prior asset portfolio upward is to do so in a pro rata fashion. Any other method proposed for adjusting the prior asset portfolio upward must be clearly documented in the Actuarial Memorandum and shall not involve changing the asset composition of the prior asset portfolio but shall constitute only additions to that portfolio.

II. as described in subsection a.2.a)(I)(ii), then the prior asset portfolio shall be adjusted upward as needed in a pro rata fashion using assets as described in subsection a.2.a)(I) (ii).

Regardless of which portfolio is chosen for the initial deterministic reserve calculation, if the initial or subsequently determined, reserve is less than the prior reserve estimate, then the prior asset portfolio shall be adjusted downward as needed in a pro rata fashion.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-22

Date Adopted by Emerging Actuarial Issues (E) Working Group

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Date Adopted by Financial Condition (E) Committee

December 20, 2012.

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E/8D

Issue / Question

1. Consider the following: A universal life policy with a secondary guarantee requires that a shadow account be maintained at a positive level for the secondary guarantee to remain in effect. Once the shadow account value goes down to zero, the secondary guarantee terminates and cannot be reactivated. There is only one set of charges and credits that apply to the shadow account. In determining reserves for this policy under section 8E, would the assumption be made that the secondary guarantee terminates at the end of the first policy year since, if only the minimum premium is paid, the shadow account value would be zero at the end of the first policy year?

2. If the policy was written before 2012, would it be subject to section 8D?

Interpretation of Emerging Actuarial Issues (E) Working Group

3. For issues in or after January 1, 2013, 8E would be applicable. But the policy, as described, would not fit into Method I because the minimum premium derived according to Method I would not satisfy the secondary guarantee requirements. Calculation of the reserve using Method I requires that the minimum premium keep the secondary guarantee in effect. Therefore, it must be reserved according to Method II.

4. For issues between July 1, 2005 and December 31, 2012 (inclusive), any regulatory response regarding applicability of Section 8D would require analysis of the policy form and dialog with the valuation actuary.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-23

Date Adopted by Emerging Actuarial Issues (E) Working Group

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December 20, 2012

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E

Issue / Question

1. Under 8E, Method I, Policy Design #1 applies for policies containing a secondary guarantee that uses a shadow account with a single set of charges and credits. For those policies, the minimum gross premium for any policy year is the premium that, when paid into a policy with a zero shadow account value at the beginning of the policy year, produces a zero shadow account value at the end of the policy year, using the guaranteed shadow account charges and credits specified under the secondary guarantee. Presumably, this will result in a yearly renewable term (YRT)-like pattern for the minimum premium.

2. The actuarial opinion required by 8E includes the statement "the minimum gross premiums determined under Policy Design # ___ are not inconsistent with the minimum premiums, charges and credits that are expected to apply under the policy." What is meant by "expected to apply"?

3. Since it is not likely that the policyholder will fund the policy using the YRT-like pattern that is the minimum premium, it does not seem as if "expected to apply" means "expected to be paid." It appears that "expected to apply" should be interpreted to mean that the YRT-type pattern will either fund the secondary guarantee or it is less than the minimum amount necessary to fund the guarantee.

4. The phrase “expected to apply" is intended to mean that the minimum premiums determined ($0- to-$0) are based on charges/credits generally consistent with those expected to apply to premium scales likely to be received from policyholders. For example, high premium loads at later durations would not be expected to apply for products with charges and credits that encourage a limited-pay or single-pay premium pattern. Other design features that should give the opining actuary pause, and could draw regulatory scrutiny, include negative charges and credits or unusual patterns of charges and credits. In addition, the actuary should not favorably opine on a product for Method I reserves with variables resulting in minimum gross premiums that would be inconsistent with the premiums a reasonable person would pay to limit advance funding. If the actuary is unable to opine favorably, the reserves should be calculated under Method II.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-24

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Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation

Issue / Question

1. A shadow account product has a design feature where the premium load is expressed as a fixed percentage of premium up to the target premium, where the target premium is reasonably consistent with level premium funding of the lifetime guarantee. In effect, there is a fixed dollar cap on the annual premium charge. The literal form of the charge is simply a specified percentage of premiums up the target premium and 0% thereafter. This will always mathematically produce the same result as the capped charge described above. Please clarify that a fixed dollar cap for the premium load, regardless of how the cap is expressed, does not make such a product incompatible with Policy Design # 1.

Interpretation of Emerging Actuarial Issues (E) Working Group

2. A flat percentage of premium charge, subject to an annual maximum, would be compatible with Policy Design (PD) #1 provided the actuary is able to issue an unqualified actuarial opinion. The specified percentage rate subject to an annual maximum may be construed as a single rate even though an alternative expression of this charge could be viewed as involving a second rate equal to zero. However, it should be noted that the actuary might be unable to opine favorably in the case of designs with credit/charge structures that encourage limited-pay premium schedules.

3. The above interpretation does not extend to designs using a flat percentage load for premiums up to a break point and a different (non 0%) load for premiums above that. Such a design should be considered as PD#3, as would any design with tiered interest rate credits or other tiered credits/charges.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-25

Date Adopted by Emerging Actuarial Issues (E) Working Group:

January 30, 2013

Date Adopted by Financial Condition (E) Committee:

February 20, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E

Issue / Question:

Does the exemption for UL policies with short guarantee periods (see below) still apply in Section 8E of AG38?

This language is from the XXX model reg (Model 830)

3.A.(2) This regulation shall not apply to any universal life policy that meets all the following requirements:

(a) Secondary guarantee period, if any, is five (5) years or less;

(b) Specified premium for the secondary guarantee period is not less than the net level reserve premium for the secondary guarantee period based on the CSO valuation tables as defined in Section 4F and the applicable valuation interest rate; and

(c) The initial surrender charge is not less than 100 percent of the first year annualized specified premium for the secondary guarantee period.

Interpretation of Emerging Actuarial Issues Working Group:

Yes.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-26

Date Adopted by Emerging Actuarial Issues (E) Working Group

February 12, 2013

Date Adopted by Financial Condition (E) Committee

April 8, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D

Issue / Question:

Section 8D(a) references the deterministic reserve calculation in the VM20 valuation manual in the definition of the Primary Reserve Methodology. As part of the asset assumptions used in the deterministic reserve calculation, page 82 of the VM20 manual describes the derivation of the Illustrative Current Market Benchmark Spreads. We have reviewed the JP Morgan US Liquid Index data referenced, and the final published values appear to be derived from the underlying data for the index as opposed to referencing published table views. Does the Working Group agree that using an updated table would be preferred? Would the Working Group consider publishing an updated table as of 9/30 or providing additional details on how the table values (shown on page 89) were derived? The values for Table G (page 90) for the below investment grade bonds were taken directly from the source index so they are easy to replicate.

Interpretation of Emerging Actuarial Issues Working Group:

For the 12/31/12 AG 38, 8D valuation it may be assumed that the 9/30/09 Tables H & I approximate both Tables F & G and Tables H & I as of 12/31/12. This assumption is based on benchmarking with current spread information from other sources as of 12/31/12. It is understood that strict technical compliance for each and every asset may not be possible due to modeling limitations. Professional judgment should be used to produce results that comply with the spirit of this standard, i.e., no lessening of conservatism. For example, if a company has access to current data sources and can reconstruct Tables F and G as of 12/31/12 then this would be an acceptable approach. In any event, appropriate explanation and justification should be provided for the methodology that was employed and the results that were obtained. The NAIC intends to provide updated tables for future year end AG 38, 8D, valuations.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 12-27

Date Adopted by Emerging Actuarial Issues (E) Working Group

February 12, 2013

Date Adopted by Financial Condition (E) Committee

April 8, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8D

Issue / Question:

If the modified VM-20 deterministic reserve ends up being the minimum reserve held in the AG 38 8D calculation, can a reinsurance reserve credit also be calculated under the guidance of VM-20 (in particular for YRT reinsurance)?

Interpretation of Emerging Actuarial Issues Working Group:

The Section 8D reserve methodology (VM-20 deterministic) applies for calculating the company's aggregate gross reserve before reinsurance. AG 38, 8D, does not address how the credit for reinsurance is determined. The approach to determine the credit for YRT reinsurance shall be documented in the stand-alone Actuarial Memorandum required by AG 38, Section 8D(c).

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-28

Date Adopted by Emerging Actuarial Issues (E) Working Group

February 12, 2013

Date Adopted by Financial Condition (E) Committee

April 8, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation

Issue / Question:

A product has a shadow account product design feature where, in addition to the fixed charges and credits associated with the policy, there is a shadow account premium charge in the event that the policyholder underfunds the policy. This premium charge is expressed as a fixed percentage of the premium shortfall when compared to a given level premium.
Please clarify whether a shadow account charge expressed as a fixed percentage of the premium shortfall is regarded as “multiple sets of charges” or as a “single set of charges” and thus whether such a product is compatible with Policy Design # 1 or Policy Design # 3.

Interpretation of Emerging Actuarial Issues Working Group:

This charge and treatment as Policy Design 1 does not appear consistent with the type of charge and treatment addressed by adopted INT 24 (formerly referred to as Pending Submission 6 prior to its adoption). INT 24 deals with a single charge that all policyholders will incur which stops after a certain level of premiums have been paid. The charge described here is not incurred by all policyholders and provides the potential for a reserve premium being subject to the full impact of this charge whereas the premiums actually expected to be paid would not incur this charge.
More information is needed to fully assess the applicable Policy Design but based on the information provided Policy Design 3 appears appropriate.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-29

Date Adopted by Emerging Actuarial Issues (E) Working Group

April 4, 2013

Date Adopted by Financial Condition (E) Committee

April 8, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E I) 3 Actuarial Opinion and Company Representation section

Issue / Question:

A company currently issues a ULSG product that is clearly a Policy Design #3. Two hypothetical examples of the charge/credit structure are shown in Tables 1 and 2 below. Under either structure, the policy form:

- Is clearly Policy Design #3
- Does not run afoul of the "Index plus 3%" of 8E

The purpose of the bifurcated cost of insurance charge structure in Table 1 or bifurcated premium charge structure in Table 2 is to optimize management of policyholder premium paying pattern behavior. The exact insurance charge for any given policy under the Table 1 design is either COI 1 or COI 2, where the rate is determined by comparing the actual fund value to a pre-defined fund value. If the actual fund value is in excess of the pre-defined fund value, COI 1 is used, otherwise COI 2 is used. Similarly, the exact premium charge amount for any given policy under the Table 2 design is PremPct1 for amounts paid up to a target amount plus PremPct2 for amounts paid in excess of the target amount.
The company's approach to establishing statutory reserves has always been to determine AG XXXVIII Step 1 minimum premiums based on the lowest charges from Table 1 (or Table 2). The actuary concludes that everything in the reserving practices of the company with respect to this policy form is in compliance with the letter and spirit of AG XXXVIII, and except for the third statement in the Actuarial Opinion (of Section E), the actuary feels s/he could sign such an attestation. The third statement declares "the minimum gross premiums determined under Policy Design #3 are not inconsistent with the minimum premiums, charges and credits that are expected to apply".

What is the actuary expected to do in such a situation?

	TABLE 1						TABLE 2			
									Up to Target	In Excess
	COI_1	COI_2	Interest	Prem Load			COI	Interest	PremPct1	PremPct2
45	0.000066	0.000231	3.75%	15%		45	0.000149	4.00%	15%	5%
46	0.000108	0.000378	3.75%	15%		46	0.000243	4.00%	15%	5%
47	0.000146	0.000511	3.75%	15%		47	0.000329	4.00%	15%	5%
48	0.000180	0.000630	3.75%	15%		48	0.000405	4.00%	15%	5%
49	0.000212	0.000742	3.75%	15%		49	0.000477	4.00%	15%	5%
50	0.000242	0.000847	3.75%	15%		50	0.000545	4.00%	15%	5%
51	0.000276	0.000966	3.75%	15%		51	0.000621	4.00%	15%	5%
52	0.000316	0.001106	3.75%	15%		52	0.000711	4.00%	15%	5%
53	0.000364	0.001274	3.75%	15%		53	0.000819	4.00%	15%	5%
54	0.000422	0.001477	3.75%	15%		54	0.000950	4.00%	15%	5%
55	0.000486	0.001701	3.75%	15%		55	0.001094	4.00%	15%	5%
56	0.000556	0.001946	3.75%	15%		56	0.001251	4.00%	15%	5%
57	0.000632	0.002212	3.75%	15%		57	0.001422	4.00%	15%	5%
58	0.000712	0.002492	3.75%	15%		58	0.001602	4.00%	15%	5%
59	0.000796	0.002786	3.75%	15%		59	0.001791	4.00%	15%	5%
60	0.000882	0.003087	3.75%	15%		60	0.001985	4.00%	15%	5%
61	0.000972	0.003402	3.75%	15%		61	0.002187	4.00%	15%	5%
62	0.001070	0.003745	3.75%	15%		62	0.002408	4.00%	15%	5%
63	0.001180	0.004130	3.75%	15%		63	0.002655	4.00%	15%	5%
64	0.001310	0.004585	3.75%	15%		64	0.002948	4.00%	15%	5%
65	0.001470	0.005145	3.75%	15%		65	0.003308	4.00%	15%	5%

Interpretation of Emerging Actuarial Issues Working Group:

As indicated in INT 23, the actuary who is unable to opine favorably would be required to calculate reserves in accordance with Method II.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-30

Date Adopted by Emerging Actuarial Issues (E) Working Group

June 6, 2013

Date Adopted by Financial Condition (E) Committee

July 17, 2013

Reference

Actuarial Guideline 38- The Application of the Valuation of Life Insurance Policies Model Regulation, Section 8E

Issue / Question:

Does Section 8E apply to the following.... (a) a 10 year secondary guarantee of the cumulative minimum premium variety where there is no interest credited to the premiums, and premiums are expected to be level (b) same question as above except the secondary guarantee period is 15 years.

Interpretation of Emerging Actuarial Issues Working Group:

Yes. Section 8E applies to both, for policies issued on or after 1/1/2013.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-31

Date Adopted by Emerging Actuarial Issues (E) Working Group

August 23, 2013

Date Adopted by Financial Condition (E) Committee

August 26, 2013

Reference

Subsection 8D states in the second paragraph that: "This section does not apply if the minimu gross premiums for the policies are determined by applying the set of charges and credits that produces the lowest premiums, …"

Interpretation ACT INT 12-02 states that a company may switch between the Primary Reserve Methodology and the Alternative Reserve Methodology.

Issue / Question:

Can a company use the Alternative Reserve Methodology found in sub-section 8D of AG38 for a policy with multiple sets of interest credits or charges if the reserves have previously been calculated using the lowest minimum gross premiums?

Interpretation of Emerging Actuarial Issues Working Group:

The applicability language in the second paragraph of AG 38, Section 8D, should not be interpreted to preclude a company from using AG 38, Section 8D(b), "Alternative Reserve Methodology", pursuant to the requirements of 8D(b) and any applicable interpretations adopted by the NAIC.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-32

Date Adopted by Emerging Actuarial Issues (E) Working Group

August 23, 2013

Date Adopted by Financial Condition (E) Committee

August 26, 2013

Reference

Regulation XXX; Actuarial Guideline 38, 8D

Issue / Question:

The company states that reserves equal to the deterministic reserve required in the valuation manual of the valuation law (model 820) are lower than produced under the above methodology, but states that it would hold reserves per the valuation manual if that produced greater reserves in aggregate for the block. If tested for each policy, the reserve required per the valuation manual would in some cases be higher than as calculated based on regulation XXX. Can the valuation manual floor be applied in aggregate rather than for each policy?

Interpretation of Emerging Actuarial Issues Working Group:

The deterministic reserve as required by Actuarial Guideline 38 8D(a) should be applied in the aggregate versus policy by policy.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-33

Date Adopted by Emerging Actuarial Issues (E) Working Group

August 23, 2013

Date Adopted by Financial Condition (E) Committee

August 26, 2013

Reference

Section 7 of AG38 and Steps 1, 2, and 8 of Section 8E of AG38

Issue / Question:

Does the language "This result may be negative." occurring twice in Step 3 of Section 8E of Actuarial Guideline 38 (AG 38) apply only to the Method II reserve approach in AG 38 or to both Method I and Method II reserve approaches? Step 3 of Section 8E of AG 38 provides for the determination of the amount of actual premium payments (or shadow account) greater than or less than the minimum gross premiums (or shadow account based on minimum premiums), as defined in Section 8E.

The issue regarding the referenced language relates to the interpretation of Step 3 as it applies particularly to (i) cumulative premium secondary guarantee designs with a "premium catch-up provision" or (ii) shadow account secondary guarantee designs where, if the shadow account is below the level necessary to maintain the secondary guarantee, there is a "catch-up provision" where the shadow account may be reinstated prior to the end of the secondary guarantee period.

In addition to Section 8E of AG 38, it appears that Section 7 of AG 38 applies in this situation. For Section 8E Method I reserve calculations, the language of Section 7 appears to deal with any deficiency indicated in Step 3 of Section 8E satisfactorily since that deficiency is measured relative to the guarantees (cumulative premium or shadow account). In this case, the value of the numerator in Step 3 of Section 8E would be zero and the floor basic and deficiency reserve would be set at the minimums defined in Section 7.

However, for Section 8E Method II reserve calculations, for purposes of applying Section 8E, the deficiency in Step 3 is measured relative to the premium defined in Step 1 which is the schedule of minimum gross premiums that create the greatest deficiency reserve rather than the schedule of minimum gross premiums based on the policy guarantees. This is inconsistent with the requirements and intent of Section 7 and therefore would allow for the ratio in Step 4 of Section 8E to be negative.

Interpretation of Emerging Actuarial Issues Working Group:

The recommended response is essentially correct. The phrase, "This result may be negative" applies only to Method II policies in Section 8E, Step 3. This phrase does not apply to the Step 3 amount for Method I policies given the requirements of AG 38, Section 7. Method I policies that would otherwise have a negative Step 3 amount were it not for Section 7 are those policies that are underfunded but provide for a catch up provision as addressed by Section 7. The Step 2 basic and deficiency reserves for such policies, used to calculate the "reserve floor" in Step 8 (c), must be adjusted as provided by Section 7 prior to calculating the "reserve floor" in Step 8 (c).

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-34

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 22, 2013

Date Adopted by Financial Condition (E) Committee

December 17, 2013

Reference

Actuarial Guideline 38 Section 8D.a.2(a)

Issue / Question:

Section 8D directs companies to use "…the same requirements for determining the deterministic reserve in the version of the valuation manual specified…but with two modifications…" In determining future Treasury yield rates used in calculating the sale price of any asset existing on the valuation date, this language in Section 8D of AG38 can be interpreted in one of two ways:

1. Assuming a level series of future Treasury yield curves for all future years of the model projection period. In this case, any gains or losses arising from the sale of existing assets during the projection period would be determined using a level Treasury yield curve scenario prospectively, and a spread applicable to the asset, as determined on the valuation date.

2. Assuming the series of future Treasury yield curves is that described under Scenario 12 from the prescribed set of interest rate scenarios used in the stochastic exclusion test in VM-20. To these Treasury rates is added a spread to determine the yield rate to be used on the sale of an existing asset during the model projection period.

Interpretation of Emerging Actuarial Issues Working Group:

It is recommended that approach 1, above, be the interpretation of the relevant language of Actuarial Guideline 38 Section 8D.a.2(a).

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-35

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 13, 2013

Date Adopted by Financial Condition (E) Committee

December 17, 2013

Reference

Actuarial Guideline 38 Section 8D.A.2(a)(I)

Issue / Question:

Section 8.D.A.2(a)(I) states, “net investment returns based on a portfolio of A-rated corporate bonds purchased in the year of issue of the policies based on yields available in the year of issue of those bonds” shall be calculated.

A possible interpretation of this language is that a company may be permitted to determine this hypothetical portfolio book yield for each year using their actual A-rated bonds purchased in that year, i.e. their own A-rated bonds. Is this approach acceptable?

Interpretation of Emerging Actuarial Issues Working Group:

It was the intent of this provision that a company use a hypothetical portfolio composed of A rated corporate bonds with yields commensurate with the A-rated corporate bond yields\ available in the year of issue. If the yields associated with the company's actual A-rated bonds purchased in the year of issue are commensurate with A-rated corporate bond yields available in the year of issue, then the company's approach is acceptable. If the yields associated with the company's bonds are significantly higher than A-rated corporate bond yields available in the year of issue, then the approach is unacceptable.

If such an approach was used, the appointed actuary should address this question in the memorandum. Reasonable approaches for comparison to a company's assets include using a published index of A-rated corporate bond yields such as Moody's at an appropriate point in the year of issue or an average over the course of the year. Another reasonable approach would be to use a Treasury yield curve at an appropriate point in the year of issue or an average over the course of the year plus an appropriate published spread of A-rated corporate bond yields over Treasuries. An appropriate point in time would be June 30 of that year if the business was sold uniformly throughout the year. If the comparison does not show the yields from company’s assets to be commensurate with the published index or adjusted yield curve rate, then (a) the sample size of the company’s own A-rated portfolio relative to the total portfolio backing the liabilities, and (b) the year to year consistency of asset allocation become major items to be addressed in the memorandum.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-36

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 13, 2013

Date Adopted by Financial Condition (E) Committee

December 17, 2013

Reference

Actuarial Guideline 38 Section 8D.a

Issue / Question:

Section 8D.a. applies to a company's aggregate gross reserve before reinsurance. The reserve calculation requires a projection of future year-by-year cash flows, which includes such items as investment earnings and general insurance expenses. If a company has ceded 100% of the business to an authorized reinsurer by use of coinsurance, the assets and net liabilities are no longer on the ceding company's books. Additionally, the administration is also generally transferred to the reinsurer. In such circumstances, the projection of future cash flows is "hypothetical" in that one must assume a starting asset portfolio, future investment strategy, future general insurance expenses, and so on. Furthermore, the ceding company generally does not have the data or systems to determine the reserves and must rely on the assuming company.
Since the assuming company is required to calculate the reserves on both direct and assumed business, may the ceding company use the reserves as reported by the reinsurer in the reinsurer's annual statement?

Interpretation of Emerging Actuarial Issues Working Group:

Under 100% coinsurance agreements with an authorized reinsurer, the ceding company is permitted to report reserves equal to those calculated by the reinsurer in the reinsurer's Exhibit 5/Schedule S.

Note that this interpretation was not being requested for coinsurance with funds withheld, modified coinsurance, or agreements where the reinsurer is unauthorized.

The Working Group recommends the above interpretation as guidance for yearend 2013, provided there is no conflict with the accounting requirements in the Accounting Practices and Procedures Manual. The issue/question will be submitted to the Life Actuarial (A) Task Force for broader consideration and possible amendment to the valuation manual.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 13-37

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 13, 2013

Date Adopted by Financial Condition (E) Committee

December 17, 2013

Reference

Actuarial Guideline 38 Sections 8B and 8C

Issue / Question:

Step 4 of Section 8E says "…determine the minimum amount of shadow account required to fully fund the guarantee." Should this determination take into account actual history, or is this a purely theoretical value?

Consider a hypothetical policy valued on its 5th anniversary. It has a shadow fund value of $12,000. Premiums of $2,500 were paid on each anniversary. If the policyholder paid an additional $63,000 (net of premium loads) on the valuation date, the guarantee would be fully funded. However, due to the product design, if the $12,000 shadow fund value resulted from a single premium of $10,000 at issue, the guarantee would be fully funded by payment of an additional $60,000 (net) at the valuation date. Is the "minimum amount" $75,000 or $72,000?

Interpretation of Emerging Actuarial Issues Working Group:

Step 4 of Section 8E states that the determination is to be made as of "the valuation date for the policy being valued…", indicative of a seriatim calculation that considers the actual circumstances of the policy. If on the valuation date a specific set of charges and credits are applicable for future shadow account calculations, such charges and credits should be used in the determination regardless of any more favorable charges and credits that may have been available as of the issue date.

Given the information that the policyholder has no control over the future charges and credits to be applied in fully funding the guarantee, it is presumed that a single set of charges/credits (with no caps or floors) is operative as of the valuation date. While an unqualified response is not possible in the absence of a full understanding of the policy design, the minimum amount appears to be $75,000 rather than $72,000.

Also, per AG38, Section 8E, the actuary must ensure that the methodology is compatible with the intent that the funding ratio (Step 3 result divided by the Step 4 result) measures the level of prefunding.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 14-38

Date Adopted by Emerging Actuarial Issues (E) Working Group

August 14, 2014

Date Adopted by Financial Condition (E) Committee

August 18, 2014

Reference

Actuarial Guideline 38 Section 8D

Issue / Question

1. Actuarial INT 27 clarifies that AG38, Section 8D, addresses the gross reserve requirements and required documentation regarding reinsurance. In reviewing the AG 38, Section 8D Actuarial Memorandum and reinsurance information, it appears that guidance is needed to address situations where the YRT reinsurance agreement reserve credit taken may be significantly different than the reserve an assuming company has set up. Such a significant difference can be due to a larger credit being calculated under VM-20 assumptions versus that set up by an assuming company. Additionally, in some cases the higher gross reserve required under the AG 38, Section 8D modified deterministic reserve, was not reported in the statutory blank prior to the reinsurance credit being taken.

Interpretation of Emerging Actuarial Issues (E) Working Group

2. The reserve established pursuant to AG 38, Section 8D (AG38-8D), should be reported on a gross basis prior to any adjustment for reinsurance. In addition, the reserve credit for reinsurance on policies subject to AG38-8D should be calculated using current statutory requirements and mortality and interest applicable under the AG38-8D.a.1. calculation.

3. Since AG38-8D does not address credit for reinsurance and only addresses calculation of the gross reserve, any determination of such credit would be outside of AG38-8D and, therefore, based on current statutory requirements and accepted practices. For example, for the calculation of the ceding credit to be posted in the statutory statement, current accounting guidance (including SSAP No. 61R, paragraph 37) should be followed. And for asset adequacy analysis, both for general testing of aggregate reserves and for the standalone analysis required by AG38-8C, currently accepted actuarial practice should be followed. AG38-8D does not incorporate VM-20 directly into either of these.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 14-39

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 14, 2014
Revised November 2, 2015

Date Adopted by Financial Condition (E) Committee

November 18, 2014
Revised November 21, 2015

Reference

Actuarial Guideline 38 Section 8D. a.2.a)(I), Section 7.D. of VM-20

Issue / Question

Subsection a.2. of Section 8D provides for two exceptions to the usual deterministic reserve requirements of VM-20 in calculating the gross premium reserve in Section 8D.a.2. One of these exceptions, in subsection a.2.a)(I), relates to net investment earnings on starting assets and limits those earnings to "…the lesser of (i) the actual portfolio net investment returns and (ii) the net investment returns based on a portfolio of A-rated corporate bonds…".

The language of Section 8D.a.2.a)(I) is not prescriptive as to the process for determining this net investment earnings comparison. One option is to compare actual portfolio yields to hypothetical portfolio yields as of a single point in time, most logically the valuation date. Another option is to develop both an actual and hypothetical portfolio as of the valuation date and project future asset cash flows and net investment returns prospectively and then use the lesser earning portfolio net investment return in each future year. Other prospective-type approaches to determining the Section 8D.a.2.a)(I) lesser net investment return portfolio are also possible. These lesser returns are then combined, in some fashion, with the net reinvestment return prescribed in Section 8D.a.2.a)(II) to develop the final path of discount rates used in the final Section 8D.a.2.c) reserve calculation.

In determining an appropriate interpretation of the language of Section 8D.a.2.a)(I) an important question to ask is: Is a prospective-type interpretation and approach illustrated above, or something similar, consistent with the determination of a single starting asset portfolio as described in Section 7.D. ofVM-20? The objective of the requirement in Section 8D.a.2.a)(I) is to impose a restriction on the determination of the starting asset portfolio required under VM-20 for the deterministic reserve calculation, not to anticipate the use of multiple portfolios prospectively. The use of future year-by-year net investment returns from multiple portfolios (actual and hypothetical) would appear to be inconsistent with the starting asset portfolio requirement of VM-20.

The issues at hand are twofold:

1. Does a prospective future net investment return comparison interpretation of the language of Section 8D.a.2.a)(I) create an inconsistency with the language of Section 7.D. of VM-20 with respect to the requirements for utilizing a single starting asset portfolio in the deterministic reserve calculation?

2. Given the multitude of possible approaches that might be used, does a prospective future net investment return comparison interpretation of the language of Section 8D.a.2.a)(I) lead to the creation of a non-level playing field beyond the range of approaches available in interpreting Section 8D.a.2.a)(I) in a manner that is consistent with VM-20?

Interpretation of Emerging Actuarial Issues (E) Working Group

For 12/31/2014 and later Section 8D submissions, for purposes of determining the starting asset portfolio, the language of Section 8D.a.2.a)(I) is interpreted such that the actual/hypothetical starting asset portfolio net investment return comparison is made as of the valuation date and not prospectively. Examples of how the comparison may be made include (i) a comparison of the weighted average hypothetical portfolio versus actual portfolio net investment returns as of the valuation date or (ii) a historical issue-year-by-issue-year hypothetical versus actual portfolio net investment return comparison, perhaps resulting in a starting asset portfolio as of the valuation date that is a hybrid of the company's actual portfolio assets for certain issue years and a hypothetical asset portfolio for other issue years.

For purposes of this comparison for 12/31/16 and later, the actual portfolio net investment return is adjusted by the current amortization of IMR allocated to the portfolio. This adjustment is made only for the comparison of portfolio yields to determine the appropriate portfolio to use in the development of the deterministic reserve. The reserve amount is then determined following the procedure defined in VM-20.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 14-40

Date Adopted by Emerging Actuarial Issues (E) Working Group

November 14, 2014

Date Adopted by Financial Condition (E) Committee

November 18, 2014

Reference

Actuarial Guideline 38 Section 8D.a.2.c) and Section 7.C.4. of VM-20

Issue / Question

Subsection a.2.c) of Section 8D provides for the calculation of gross premium Primary Reserve to be performed using the path of net investment returns determined in Section 8D.a.2.b) "…to discount the cash flows applicable to those policies.", i.e. those policies subject to Section 8D. The cash flows referenced in Section 8D.a.2.c) are to include, as per Section 4.A.3. of VM-20, death and cash surrender benefits. For the ULSG policy types subject to the requirements of Section 8D, if the interest rate credited to the policy account value is a non-guaranteed element (NGE), the value of the benefits be directly impacted by the net investment earnings of the assets used to back the reserves held in support of the risks assumed under the policies. In addition, lapse rates for these ULSG policy types also may vary depending on the net investment earnings of the assets used to back the reserves held in support of the risks assumed under the policies.
Section 7.C. of VM-20, covering NGE cash flows, requires, in subsection 4. that:

"Projected levels of NGE in the cash flow model must be consistent with the experience assumptions used in each scenario. Policyholder behavior assumptions in the model must be consistent with the NGE assumed in the model."

There is only a single (level) interest rate scenario applicable for the Section 8D.a.2. reserve gross premium reserve calculation so the issue centers on whether the NGE and policyholder behavior assumptions are "consistent" with the experience assumptions and NGE respectively.

Interpretation of Emerging Actuarial Issues (E) Working Group

This interpretation permits the delinking of the liability cash flows used in the Section 8D.a.2.c) gross premium reserve calculation from the net investment returns determined as in Section 8D.a.2.b) provided the actuary can provide justification that the impact of such delinkage on the Section 8D.a.2. reserve calculation is consistent with the requirements of Section 7.C.4 and Section 2G of VM-20.

The information required to support the delinked approach would need to present reasonable justification and reflect the consistency of the assumptions used with the particular company's anticipated experience and ULSG product structures. The information provided should be adequate to support the assertion that the requirements of Section 2.G. and Section 7.C.4. of VM-20 have been achieved.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 14-41

Date Adopted by Emerging Actuarial Issues (E) Working Group

December 11, 2014

Date Adopted by Financial Condition (E) Committee

December 12, 2014

Reference

Actuarial Guideline 38 Section 8D. a.2.a)(I)

Issue / Question

Section 8D directs companies to test: "The company's aggregate gross reserve before reinsurance for the business subject to this Section 8D to be reported in the December 31, 2012, and subsequent annual statutory financial statements of the company will be the aggregate reserve under 1 below, plus any excess of the aggregate reserve determined as defined in 2 below, over 1".

Furthermore Section 8D requires that for existing assets: "The projected net investment earnings from the starting assets shall be the lesser of (i) the actual portfolio net investment returns and (ii) net investment returns based on a portfolio of A-rated corporate bonds purchased in the year of issue of the policies based on yields available in the year of issue for those bonds."

1. **Is it required to test reinsurance assumed?**

Some companies only test at the direct writer level (using hypothetical portfolios) while other companies test the reinsurance assumed against actual assets.

2. **Is it appropriate to use hypothetical portfolios for testing?**

a. Assuming a company where the reserves are 100% ceded (all but an insignificant amount was coinsurance) and no assets remain. May the company test on the basis of a hypothetical portfolio of A rated bonds described above? While this may be the only interpretation available, there is no connection between the assets and the liabilities or any company investment policy.

b. When the existing asset yield is below that of the hypothetical portfolio is it required to take a hair-cut on the yields of the existing assets or is it acceptable to use a hypothetical portfolio of just one bond per issue year instead?

Interpretation of Emerging Actuarial Issues (E) Working Group

1. **Do the requirements of AG38-8D apply to applicable reinsurance assumed?**

Yes. It is required to apply the requirements of AG38-8D to include reinsurance assumed on risks that are within its scope. AG38-8D(a) includes the company's "aggregate gross reserve before reinsurance…". This is interpreted, for applicable business, to be the company's direct written business plus coinsurance reinsurance assumed and prior to any reinsurance ceded. Only this interpretation is consistent with the scope of AG38-8D and the reporting of reserves in Exhibit 5 of the annual statement.

2. **Is it appropriate to use hypothetical portfolios for testing?**

There are two types of hypothetical portfolios possible for this question.

The first type of hypothetical portfolio is required by AG-38, 8D(a)(2)(a)(I)(ii). This citation provides for a derivation of a hypothetical "portfolio of A rated corporate bonds purchased in the year of issue of the policies based on yields available in the year of issue for those bonds."

There may be a second type of hypothetical portfolio to use in place of the actual portfolio pursuant to AG38, 8D(a)(2)(a)(I)(i) if that actual portfolio is incomplete or unavailable for a company that has ceded some or all of the risk through coinsurance. In this case the company may coordinate with and make use of the reserve calculations of the assuming reinsurer, as provided in VM-20 Section 8.A.1.

However the ceding company, in calculating the pre-reinsurance ceded reserve or gross reserve required by AG-38 Section 8D, must assure that such modeling and assumptions are appropriate as provided by the first paragraph of VM-20 Section 8.D.2 and as provided by VM-20 Section 8.D.2.b.

Interpretation of the Emerging Actuarial Issues (E) Working Group

Actuarial INT 15-42

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August 17, 2015

Reference

Actuarial Guideline 38 Section 8E

Issue / Question

A universal life policy contains a secondary guarantee based on the value of a shadow account. As long as the shadow account is positive, the policy is guaranteed not to lapse, even if the cash surrender value is not positive. The shadow account value accumulates with interest from one period to another, with deductions for COI charges. The interest credited to the shadow account is calculated as follows:

- 10% interest is credited to the shadow account up to a threshold amount.
- 0% interest is credited to the any excess of the shadow account over the threshold amount.
- The threshold amount is equal to the accumulation of the level premium that would keep the shadow account positive throughout the secondary guarantee period, assuming 10% interest is credited.

The shadow account is not larger than the threshold amount on the valuation date. For purposes of the fourth step in sections 8B and 8C of the Guideline, what interest rate should be used to determine the shadow account value that would fully fund the secondary guarantee?

Interpretation of Emerging Actuarial Issues (E) Working Group

This interpretation is qualified for issues within the scope of AG 38, Section 8E, only and applies to those section 8E products issued on and after 1/1/16. The intent of the ratio in AG 38 8E Step 4 is to measure the level of pre-funding and to specify its use to establish reserves in its application to the Net Single Premium. The objective is to provide for reserves equal to the appropriate portion of the Net Single Premium represented by pre-funding as of the valuation date. The ratio is a practical convention for this objective.

For shadow account secondary guarantee product designs with multiple charges/multiple credits where consistency of charges and credits in the numerator and denominator of the ratio is difficult to achieve, reasonable efforts must be made to establish a ratio which, on an aggregate basis, carries out the objective above.

Otherwise, reasonable efforts should be made to produce a conservative estimate of the present value of future benefits on a statutory basis which, in the aggregate, carries out the objective above. Such conservative estimate, when divided by the Net Single Premium calculated in AG 38 8E, Step 5, produces the ratio.

For any shadow account secondary guarantee product designs with multiple charges/multiple credits the denominator of the ratio shall be limited to be no larger than the Net Single Premium as calculated in AG 38 8E, Step 5.