AMERICAN ACADEMY of ACTUARIES

April 18, 2023

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

Re: APF 2023-05; Hedging language to address index credit hedging in VM-21

Dear Chair Hemphill,

The Variable Annuity Reserves and Capital Working Group (VARCWG) of the American Academy of Actuaries[1] (the "Academy") appreciates the opportunity to provide comments on the proposed changes to VM-21 as outlined in APF 2023-05.

VARCWG offers the following comments and proposals:

Recommendation for a principle-based approach

First, the VARCWG wishes to reiterate what has been stated in the past, including the most recent comment letter from the Academy's Life Valuation Committee on APF 2020-12 in reference to modeling hedges. The VARCWG believes companies should model their investment strategies as part of a principle-based reserve calculation, which includes the modeling of hedging activities with appropriate margins.

The ideal approach for index credit hedging would be to follow the VM-20 approach, where hedge cash flows are modeled consistently with how other cash flows are projected. Any "error" to hedge cash flows can be reflected in margins that are added to best estimate cash flows with the hedges reflecting the level of uncertainty in the modeled cash flows.

It should also be noted that the current VM-21 approach could result in an error/residual risk of $0 when CTE70 (adjusted) is less than CTE70 (best efforts). This approach may not capture the underlying risk and may underestimate the level of margin that would be appropriate for statutory valuation purposes.

Proposed revisions to exposed APF

Second, the VARCWG would propose the following redline revisions to the exposed APF:

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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- *VM-01*: The term "Index Credit" means any interest credit, multiplier, factor, bonus, charge reduction, or other enhancement to policy or contract values that is directly linked to one or more indices. Amounts credited to the policy or contract resulting from a floor on an index account are included. An Index Credit may be positive or negative.
- *VM-21 Section 4.A.4*: An Index Credit Hedge Margin for these hedge instruments shall be reflected in both the "best efforts" and the "adjusted" runs by reducing index interest credit hedge payoffs by a margin multiple that shall be justified by sufficient and credible company experience and account for model error. It shall be no less than [1%] multiplicatively of the portion of the interest credited that is hedged. In the absence of sufficient and credible company experience, a margin of at least [20%] shall be assumed. There is no cap on the index credit hedge margin if company experience indicates actual error is greater than [20%].

The VARCWG suggests that the margin be applied only to the portion of interest credit that is hedged.

Determining the minimum index credit hedge margins

Regarding the determination of the minimum index credit hedge margins, the Academy is currently deliberating on this topic. An approach to determine the minimum hedge error is being designed for the VM-22 field test, which will be a joint effort between the Academy, NAIC, and The American Council of Life Insurers. VARCWG would propose the same approach be used for VM-21 when that approach is finalized.

Other comments for consideration

In any field test to determine level of hedge margins, the VARCWG suggests testing alternative methodologies as well, such as the VM-20 principle-based approach.

We thank you for your consideration of these comments and would be pleased to answer corresponding questions or provide additional support as needed. Should you have questions or comments in response to this letter, please contact Amanda Barry-Moilanen, life policy analyst (barrymoilanen@actuary.org).

Sincerely,

Maambo Mujala, MAAA, FSA
Chairperson, Variable Annuity Reserves and Capital Work Group
American Academy of Actuaries

CC: Scott O' Neal, NAIC