June 7, 2023

Dale Bruggeman,
Chair, Statutory Accounting Principles Working Group (SAPWG)
National Association of Insurance Commissioners (NAIC)

Re: 2023 Net Negative (Disallowed) Interest Maintenance Reserve (INT 23-01T)

Dear Chair Bruggeman,

The Life Valuation Committee of the American Academy of Actuaries[1] is pleased to comment on "2023 Net Negative (Disallowed) Interest Maintenance Reserve" (INT 23-01T).

IMR in Reserve and Capital Calculations

Prior to providing specific comments on the exposure, we would like to provide the following background on how the Interest Maintenance Reserve (IMR), whether positive or negative, impacts reserving and capital calculations.

The IMR amortizes interest rate-related gains and losses from the sale of fixed income investments rather than immediately reflecting in statutory surplus. The concept of the IMR reflects that whether a company continues to hold the original fixed income investment or chooses to sell and reinvest in a like fixed income investment, it would maintain the same ability to meet future benefit obligations.

The handling of the IMR is addressed in asset adequacy testing (AAT[2]), model-based risk-based capital calculations (C-3 RBC), and principle-based reserves (PBR). AAT, PBR, and C-3 RBC all specify that an appropriate allocation of IMR (whether positive or negative) should be used to support policyholder liabilities in the calculation. It was affirmed by the year-end 2022 NAIC IMR guidance to LATF that only the portion of IMR that is admitted should be included in AAT. Companies are not required to reflect any non-admitted portion, as this may "double-count losses."

When a negative IMR is included in AAT, PBR, and C-3 RBC calculations, it reduces the amount of interest-earning assets supporting the business. The presence of a negative IMR, however, does not itself cause a reserve inadequacy if the assets sold were reinvested in higher

[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.
[2] An analysis of the adequacy of reserves and other liabilities, in light of the assets supporting such reserves and liabilities, performed in support of the actuarial opinion.

yielding assets. The IMR's impact along with other factors should be an integral part of AAT, PBR, and C-3 RBC calculations.

SAPWG Exposure Comments

The following provides observations for pros and cons on specific components of INT 23-01T from an actuarial perspective:

Require at least 300% of the Authorized Control Level risk-based capital to admit a negative IMR

Pros

- Use of a risk-based capital (RBC) threshold would allow for regulator or company review of the solvency impacts of the IMR for less capitalized companies.

Cons

- In some cases, the non-admission of the IMR may lead to a higher RBC ratio. An illustrative C-3 RBC example is provided in Appendix 1. Similarly in asset adequacy testing, if negative IMR became non-admitted, it may be offset by lower AAT reserves for one company but be a reduction of capital for another company not holding asset adequacy reserves due to the level of margin in reserves.

- There could be inconsistencies caused by the timing of when asset adequacy reserves and/or PBR calculations were performed—e.g., asset adequacy reserves completed as of 9/30 assuming admission of the negative IMR but the admission changes at year-end.

A disclosure that shows risk-based capital with and without the admitted negative IMR included in Total Adjusted Capital may also give regulators more comparable information about the impact of negative IMR on a company's solvency position.

Limit of 5% of the reporting entity's adjusted surplus[3]

Pros

- As intended, this limit would control the portion of a company's statutory surplus that is made up of negative IMR and would therefore limit the impact that admitting negative IMR could have on evaluating the company's surplus for RBC purposes.

[3] Surplus is adjusted for any net positive goodwill, electronic data processing equipment and operating system software, net deferred tax assets and admitted net negative IMR.

Cons

- A percent of surplus limit would not be needed to ensure the adequacy of reserves and appropriate capital calculations. Instead, reserve and capital adequacy may be better addressed by the inclusion of an appropriate IMR allocation in AAT, PBR, and C-3 RBC calculations.

Admittance of net negative IMR in the separate account

Pros

- INT 23-01T notes that net negative IMR will continue to be disallowed in the separate account. This would accomplish the goal of limiting the admission of negative IMR, in particular for variable products.

Cons

- In cases where the assets in the separate account are held at amortized cost, the IMR should be consistent with handling in the general account.
- Inconsistent treatment may lead to different reserve and capital requirements based on whether a product was held in the general or separate account despite both accounts holding assets at amortized cost. For example, AAT reserves on a product in a separate account would be different than if held in the general account due to whether the negative IMR was admitted and subsequently included in the assets supporting the reserves.

The Academy Life Valuation Committee would be willing to provide additional input as this exposure is being considered. Please contact Academy life policy analyst Amanda Barry-Moilanen (barrymoilanen@actuary.org) with any questions.

Sincerely,

Life Valuation Committee, American Academy of Actuaries

Appendix 1

C3 Phase 1 Example

1. Assume $100 of assets and $100 liabilities. Assets cover future claims and related expenses (no excess or shortfall in cash flow testing). Assume the company has total adjusted capital of $15. Taxes are ignored.

2. The C3 Phase 1 modeling results in a $10 requirement

Assets	Liabilities	C3 Phase 1 Amount	Total Adjusted Capital	CAL RBC Ratio	ACL RBC Ratio
$100	$100	$10	$15	150%	300%

3. If market value of assets increases to $104 due to a drop in interest rates and the assets are sold and repurchased, there would be no impact on the C3 Phase 1 requirement, assuming IMR is reflected in this calculation.

Assets	Liabilities	C3 Phase 1 Amount	Total Adjusted Capital	CAL RBC Ratio	ACL RBC Ratio
$104	$100	$10	$15	150%	300%
	IMR: $4				

4. If market value of assets decreases to $96 due to an increase in interest rates and the assets are sold and repurchased and the resulting IMR was non-admitted, Total Adjusted Capital would decrease. If negative IMR was not admitted, it would not be reflected in the C3 Phase 1 requirement, which would result in a higher proportion of interest-earning assets compared to a requirement that includes admitted negative IMR. The higher-earning assets would result in a decrease in the C3 Phase 1 requirement, thereby increasing the RBC ratio.

Assets	Liabilities	C3 Phase 1 Amount	Total Adjusted Capital	CAL RBC Ratio	ACL RBC Ratio
$96	$100	$6	$11	183%	367%
	IMR: $0				