Memo

To:	Mike Boerner, Chair, Life Actuarial Task Force
From:	Tricia Matson, Partner and Ed Toy, Director
Date:	November 18, 2021
Subject:	RRC comments regarding AG on complex assets

Background

The Life Actuarial Task Force (LATF) issued a request for feedback related to the concept of an actuarial guideline (AG) focusing on modeling of complex or high-yielding assets in asset adequacy testing (AAT). This request relates to the increasing use of complex investments to back reserves, and the importance of appropriately capturing the risks associated with those assets in AAT. RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and the LATF members.

RRC Comments

- Overall comments:
  - We applaud these efforts. There are many unique risks associated with some of the invested assets that are increasingly being used to back insurance liabilities. As noted, many of these invested assets present unique challenges due to their complexity, but they also often represent assets that are opaque, are highly volatile from a fair value standpoint and are illiquid. While these complex investments can provide benefits to the insurer and the policyholder (typically in the form of higher yields), it is critical that the reserves (and capital) supporting the business appropriately take the additional risk exposures into account.
  - We support doing this in the near term via an Actuarial Guideline. We would also encourage LATF and the NAIC to consider how to incorporate guidance more directly into the valuation manual and into the risk-based capital formula.
  - We believe that current guidance to Appointed Actuaries (in Actuarial Standards of Practice that apply to AAT) already require appropriate inclusion of asset risks in AAT; however, more specific guidance in the form of an AG may be helpful to Appointed Actuaries and may improve consistency of industry practice and policyholder protection.
- Regarding Product Scope (Should the focus be on assets supporting fixed annuities or assets supporting all life insurer liabilities subject to AAT?)
  - We believe the scope should include all products.
  - We see use of complex investments backing life insurance and long term care, and see no reason why the associated risks should be considered in fixed annuity reserves but not other types of products.

- Regarding Size Scope (Should only life insurers or blocks exceeding a certain size threshold be subject to the actuarial guideline?)
    - We do not think the size of the insurer or the block should impact application of the guidance. If an insurer is willing to take the risk, we believe the insurer should be able to appropriately understand the unique nature of some of these assets and reserve for the risk.
    - That said, if complex assets are less than some defined immaterial percentage of the total assets backing the reserves or are very short duration in nature, limiting application of the guidance might be appropriate.
- Regarding Constraints or Documentation (Should the actuarial guideline focus on establishing constraints related to the modeling of complex or high gross yield assets (impacting AAT results) or providing detailed documentation and sensitivity testing on the modeling of such assets (potentially not impacting AAT results)?)
    - We believe that a higher risk profile for any invested assets should result in additional provision for risk in the reserve analysis, and therefore we favor a "constraints" approach. We also believe that this approach is aligned with existing guidance, which requires that reserves cover moderately adverse conditions.
    - In addition to specific constraints, inclusion of explicit disclosure requirements and/or sensitivity tests may also be helpful. For example, many of the "newer" investments do not have as much historical data for use in setting assumptions regarding investment yield, cash flow profile, default or prepayment, thereby making both provisions for adverse deviation and sensitivity testing important. The availability of reliable data may also be informative in determining what would be appropriately considered "moderately adverse".
- Regarding Effective Date (Is a year-end 2022 effective date for the actuarial guideline reasonable, or should some guidance apply before that date?)
    - Since there is current guidance (albeit not necessarily prescriptive) in ASOPs, and new guidance should generally be implemented with sufficient notice so that companies can make good faith efforts to comply, we believe that year-end 2022 is sufficient.
    - We also recognize that to develop, vet, and adopt good guidance on this complex topic takes time, so it may also make sense to adopt interim guidance for year-end 2022, and further enhance that guidance for subsequent year ends.