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SPIA Interest Rates in VM-22 for Stat Reserves

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For the first time in over 30 years, changes are coming to the statutory valuation rates for Pension Risk Transfer and similar products! Over the last decade, it has become commonplace for single day transactions in the billion dollar plus range and the existing methodology, where an average of July to June yield rates is used, has started to make less sense. The lumpiness of these so-called "jumbo" transactions was one of the contributing factors leading regulators to ask the American Academy of Actuaries to help them with the development of a new interest rate methodology.

The result was the development, in less than two years, of a new interest rate methodology. This new methodology addresses issues raised by regulators, including how to handle lumpy jumbo transactions, modernization of the credit index, and better alignment of valuation rates with the assets backing the liabilities, while trying to build upon recently enacted regulatory requirements where it made sense.

The impact can be significant, especially for shorter duration liabilities. An American Academy of Actuaries analysis of a preliminary proposal similar to, but not exactly the same, as that adopted, showed up to a 2 percent decrease in the interest rate for short duration liabilities (A), around a 1 percent decrease for moderate duration liabilities (B & C), and similar interest rates for long duration liabilities (D).[1] See Figure 1.

The Statutory Valuation Rate changes are taking effect for contracts issued on or after Jan. 1, 2018. Products in scope for the new rates are:

- Single Premium Group Annuities (Pension Risk Transfer)
- Immediate Annuities
- Deferred Immediate Annuities (DIAs)
- Structured Settlements
- Payout Annuities (Settlement Options)
- Supplementary Contracts
- Living Benefits (GLWBs) and Contingent Deferred Annuities (CDAs) once account value is exhausted

The principles the American Academy of Actuaries working group used in the development of the methodology proposed to the NAIC were:

1. Valuation rates based on asset portfolios backing liability
2. Inclusion of appropriate prudence
3. Equal treatment across companies
4. Avoidance of perverse incentives
5. Consistency with other recent statutory frameworks
6. Daily valuation rate is ideal
7. Optimal tradeoff of accuracy and effort

A high level comparison of the current methodology and the resulting new methodology is shown in Table 1.

The current valuation rates use Moody's Long-Term Corporate Bond Index as the reference rate whose credit quality may not reflect the assets insurers are purchasing to back these liabilities. There is also only a single rate regardless of the duration of the liability. Taken together, these features of the current methodology could lead to carriers needing to post Asset Adequacy Testing (AAT) reserves.

The new methodology uses U.S. Treasuries plus VM-20 credit spreads and expected defaults. The distribution of credit quality is based on the public bond portion of an average life insurer's asset portfolio.

There will now be different rates for "Jumbo" contracts (initial premium greater than or equal to $250M) and "Non-Jumbo" contracts. Jumbo contracts will use a rate that is updated daily whereas Non-Jumbo contracts will use a rate that is updated quarterly.

Figure 1
SPIA Valuation Rates: Current vs. Proposed

Table 1
Current versus New Methodology

		Current	New
A	Reference Index	Moody's Long-Term Corporate Bond Index	Treasuries plus VM-20 Spreads
B	Credit Quality	Moody's Index	Based on Average Life Insurer Bond Portfolio
C	Prudence	20 percent of reference rate in excess of 3 percent	VM-20 Baseline Defaults and Spread Deduction
D	Floor	None, bias toward 3 percent	None
E	Valuation Rate Buckets	1	4 to reflect duration differences
F	Frequency of Updates	Annual	Quarterly (non-jumbo)/ Daily (jumbo)
G	Rounding	Nearest 25bp	Non-jumbo: nearest 25bp Jumbo: nearest 1bp

In addition, there will now be four different valuation rates to reflect differences in liability duration. For simplicity, there is a mapping based on two liability characteristics impactful to duration, age and the reference period (generally the certain period).

For contracts or certificates without life contingencies, Valuation Rate Buckets are assigned based on the length of the Reference Period* (RP), as follows:

RP ≤ 5Years	5Y < RP ≤ 10Y	10Y < RP ≤ 15Y	RP > 15Y
A	B	C	D

For contracts or certificates with life contingencies, Valuation Rate Buckets are assigned based on the length of the Reference Period (RP) and the Initial Age of the annuitant, as follows:

Initial Age	RP ≤ 5Years	5Y < RP ≤ 10Y	10Y < RP ≤ 15Y	RP > 15Y
90+	A	B	C	D
80–89	B	B	C	D
70–79	C	C	C	D
<70	D	D	D	D

*Reference Period - This is the rounded length of time until the last non-life-contingent payment.

The proposed rate changes were adopted by the Life Actuarial Task Force (LATF) of the National Association of Insurance Commissioners (NAIC) and are now incorporated into the Valuation Manual under VM-22. These rates replace the rates from the Standard Valuation Law under CARVM for these products.

Rates will be published by the NAIC at *http://www.naic.org/index_industry.htm*. The text of the regulation is at *http://www.naic.org/documents/cmte_a_latf_related_vm22_170407_adoption.docx*. For background on the development of the regulation, see *https://www.actuary.org/committees/dynamic/SVLMODERNIZATION*. ■

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ENDNOTES

1 Source: American Academy of Actuaries, SVL Interest Rate Modernization work group.