Bulletin 2009-03

Calculation of the Reserves for Variable Annuities that provide Guaranteed Living Benefits ("VAGLBs") in the Preparation of Statutory Financial Statements

Effective Date: February 3, 2009

The purpose of this Bulletin is to exercise the discretion provided to the Ohio Superintendent of Insurance ("Superintendent") to prescribe the method employed by Life insurance companies domiciled in the state of Ohio in the preparation of those companies statutory financial statements and to document the standard which the Department will consider a permitted accounting practice.

With the Department's review and approval, Director Hudson is permitting Life insurance companies domiciled in the state of Ohio to determine reserves for those products falling under the scope of Actuarial Guideline XXXIX ("AG 39") to use the revised guideline below as a basis.

According to Ohio Revised Code 3901.77 the Superintendent is required to adopt the forms, instructions, and manuals prescribed by the National Association of Insurance Commissioners ("NAIC"). This was accomplished by promulgation of Ohio Administrative Code Section 3901-3-18.

Ohio Law and the NAIC Accounting Practices and Procedures Manual ("Manual") allow the Superintendent to consider accounting practices that depart from those prescribed in the Manual.

These revised sections of AG 39 are effective for reporting periods ending on or after December 31, 2008 and will expire on December 30, 2009.

With respect to item 5 in section III of the guideline, the combined base and asset adequacy reserves for Actuarial Guideline XXXIV ("AG 34") along with the base reserve for AG 39 should be reported in Exhibit 5. Any decrease in the portion for AG 39 of the combined asset adequacy reserves for AG 34 versus the stand alone asset adequacy reserves for AG 39 at the beginning of the year should be reported in Exhibit 5A.

In addition, any financial benefit derived from these revised sections may not be used in the determination of any dividends or other distributions available for shareholders.

The above guideline is considered a "permitted accounting practice" and as such the procedure and disclosure required by the NAIC Accounting Practices and Procedures Manual must be complied with.

In addition, to deal with the situation where the dollar adjustment of reserves will transfer directly to Required Capital due to the nature of the TAR Calculation, the following adjustment shall be made to the TAR calculation as describe in the RBC Instruction Manual, section LR025:

> For 2008, the reserve, net of reinsurance, for the business subject to this instruction reported in the current statutory annual statement can use a reserve amount different than the amount reported in the 2008 statutory annual statement provided the difference is limited to using the reserve, net of reinsurance, that would have been calculated using the standalone asset adequacy analysis in Actuarial Guideline 39 for variable annuities with living benefits instead of incorporating variable annuities with living benefits in the asset adequacy analysis in Actuarial Guideline 34. The variable annuities with living benefits must use the same assumptions in the standalone Actuarial Guideline 39 asset adequacy analysis as were used in the Actuarial Guideline 34 asset adequacy analysis.

ACTUARIAL GUIDELINE XXXIX

RESERVES FOR VARIABLE ANNUITIES WITH GUARANTEED LIVING BENEFITS

I. Background

The purpose of this Actuarial Guideline (Guideline) is to interpret the standards for the valuation of reserves for guaranteed living benefits included in variable deferred and immediate annuity contracts (VAGLBs). This Guideline provides an interpretation of the National Association of Insurance Commissioners' (NAIC) Model Standard Valuation Law (SVL) for VAGLBs and is intended to be temporary.

The methodology does not specifically address how "base variable annuity reserves" (i.e., reserves for variable annuity contracts calculated by ignoring VAGLBs) should be calculated. Rather, it only addresses the calculation of reserves for VAGLBs to be held in the General Account.

In addition, this Guideline interprets the standards for the valuation of reserves when the VAGLB risk is reinsured.

II. Scope

This Guideline applies to variable deferred and immediate annuity contracts that provide one or more guaranteed living benefits. This Guideline does not apply to those group annuity contracts that are not subject to the Commissioners' Annuities Reserve Valuation Method (CARVM).

VAGLB designs falling under the scope of this Guideline include, but are not limited to, currently offered provisions commonly referred to as Guaranteed Minimum Accumulation Benefits (GMABs), Guaranteed Minimum Income Benefits (GMIBs), Guaranteed Minimum Withdrawal Benefits (GMWBs), and Guaranteed Payout Annuity Floors (GPAFs).

III. Text

A. Aggregate Reserves for Contracts with VAGLBs

The Aggregate Reserves for Contracts with VAGLBs are the total reserves held by the company in support of the variable annuity contracts with VAGLBs, and equals the sum of 1 and 2, where:

1. equals the aggregate reserves for the variable annuity contracts ignoring both the future revenues and benefits from the VAGLBs and after comparison to the cash value of the contracts. For the purpose of determining future revenues and benefits for VAGLBs, a charge should be imputed in the event that there are no explicit VAGLB charges.

   and

2. equals the VAGLB reserve, determined as the sum of the aggregate VAGLB charges from the date of issue to the valuation date for VAGLB benefits in-force (i.e., contracts still in-force and still eligible for the VAGLB), the sum reduced by 2.5% each calendar quarter beginning January 1, 2008 and subject to the asset adequacy analysis requirement in subsection C (i.e., each quarter the prior quarter VAGLB result is multiplied by 0.975 then the VAGLB charges from the quarter are added to the product). In the event that there are no explicit VAGLB charges, a charge should be imputed.

The VAGLB reserve must be held in the General Account. (This is in addition to any amounts in item 1 that are required to be held in the General Account).

B. Reserve for Ceded and Assumed Reinsurance

If all or a portion of the VAGLB risk is reinsured on a proportional basis, the ceding company is entitled to a corresponding proportional reinsurance reserve credit based on the VAGLB reserve held before consideration of reinsurance.

Adjustments may need to be made to the reserve credit taken by ceding companies where the underlying reinsurance treaty contains non-proportional elements.

For companies where VAGLB risk is assumed, the aggregate VAGLB reserves for contracts with VAGLBs will be the sum of a) the aggregate direct VAGLB charges in proportion to the amount of reinsurance from the issue date of the contract to the effective date of the reinsurance contract and b) gross reinsurance premiums from the effective date of the reinsurance contract to the valuation date for VAGLB benefits in force (i.e. contracts still in force and eligible for the VAGLB) and subject to the asset adequacy analysis requirement in subsection C.

C. Asset Adequacy Analysis Requirement

For valuation dates prior to December 31, 2008, T~~t~~he appointed actuary must perform a standalone asset adequacy analysis of the VAGLB reserve. For valuation dates on or after December 31, 2008, the alternative requirements in IIID may be used. If such analysis reveals a reserve shortfall, VAGLB reserves must be increased. Such analysis shall be performed reflecting the following:

1. all VAGLB benefits and expenses,

2. all VAGLB charges, and

3. the assets supporting the VAGLB reserves.

The analysis shall be performed on an aggregate basis for all contracts with VAGLBs, consistent with the requirements of the NAIC Model Actuarial Opinion and Memorandum Regulation, including the requirement that the analysis conform to the Actuarial Standards of Practice as promulgated from time to time by the Actuarial Standards Board. However, no separate actuarial opinion is required by this Actuarial Guideline.

Where the VAGLB is reinsured, the asset adequacy analysis may reflect the reinsurance. However, if the inclusion of reinsurance in the asset adequacy analysis would increase the VAGLB reserve, then reinsurance must be reflected in the analysis.

D. Alternative Asset Adequacy Analysis Requirement

For valuation dates on or after December 31, 2008, the appointed actuary may incorporate such asset adequacy analysis in Actuarial Guideline XXXIV, provided that the following conditions are met:

1. Actuarial Guideline XXXIV asset adequacy analysis scope: Testing should be performed on all blocks of variable annuity business containing a variable annuity guarantee, issued on and after January 1, 1981, including blocks of business that contain variable annuity guarantees that are assumed by the company via reinsurance or other mechanism.

2. Testing of investment volatility: Asset adequacy testing assumptions for investment returns should include, but not be limited to setting volatility assumptions for stocks, bonds, mortgages, government securities, synthetic assets (CMO's, CDO's), and derivatives that incorporate both historical and recent patterns. (In particular, a

company should not use a level set of returns over time for stocks, or any other investment, as its primary test.) A company, at its discretion, may use Actuarial Guideline XLIII or RBC C3 Phase II for guidance.

3. Policyholder behavior assumptions: Such assumptions should reflect both recent history and potential future use of policyholder exercise of any variable annuity contract options. Setting of such assumptions should generally be consistent with modeling constraints and disclosures in Appendix 9 of Actuarial Guideline XLIII (i.e., more conservative to extent there is absence of experience and preparation of a separate lapse and utilization memorandum).

4. The Actuarial Memorandum supporting the company's annual statement of actuarial opinion should be expanded to include a detailed analysis of the assumptions and conclusions of the effects of variable annuity living benefits both on reserve adequacy and potential losses under adversity, including but not limited to a description of the policies tested and excluded, the investment volatility tested, and the policyholder behavior assumptions used.

5. To the extent this change in asset adequacy analysis and scope is a change in valuation basis for the company, the Accounting Practices and Procedures Manual and annual statement instructions should be followed as appropriate to reflect this as a change in valuation basis in Exhibit 5A of the life annual statement blank.

IV. Applicability

This Guideline is effective December 31, 2002 and affects all contracts issued on or after January 1, 1981.

Since the requirements of this Guideline are intended to be temporary, this Guideline is in effect until no later than December 30, 2009.

Mary Jo Hudson
Superintendent of Insurance