

## VM-20 Asset-Related Issues

The sole item for discussion on today's 90-minute call was consideration of an AAA Life Reserves Work Group (LRWG) amendment relating to assets.

Before LRWG could discuss its proposal, NY expressed frustration with all the "last-minute" changes, ominously saying that it might submit its own changes.

The goal of the amendment is to create a consistent, realistic, and transparent environment for buying and selling fixed income assets and quantifying asset default risk in PBR. Key features of the amendment are:

- Prescribing gross spreads, based on actual current and historic market data, for public, non-callable corporate bonds as functions of credit quality and weighted average life,
- Grading from current market spreads at the valuation date to long-term benchmark spreads over three years,
- Basing long-term benchmark spreads on mean spreads over 7-15 years,
- Excluding the 7.5% highest spreads and 7.5% lowest spreads in the period to limit volatility,
- Requiring gross spreads on investments other than public, non-callable corporate bonds to be consistent with prescribed spreads,
- Establishing a floor for a minimum reserve not less than that resulting from using an alternative investment strategy of a blend of 50% A2/A and 50% Baa2/BBB,
- Permitting the model investment strategy to be complex (has assets with no prescribed spreads) or simple (has only assets with prescribed spreads) to demonstrate compliance with the alternative investment strategy, and
- Prescribing swap curve spreads.

The proposed gross spread method less default costs and investment expenses replaces the current net spread method of 4% of the appropriate Treasury rate plus 25 basis points.

NY decried certain possible unfavorable outcomes of the proposal, such as perpetuation of recent high spreads and perverse incentives to invest in lower quality assets.

Having no time to provide additional feedback, LHATF plans to schedule a conference call in two weeks to discuss the proposal.

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