Product Matters!

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NAIC Update on Issues Affecting Life and Annuity Product Development

by Andrew M. Erman

First, how do things work at the NAIC?

The NAIC has several committees, task forces and working groups that collectively serve the objectives of the NAIC. One such task force is particularly relevant to this discussion — the Life and Health Actuarial Task Force (LHATF), which is currently chaired by New Mexico (Mike Batte). This task force reports into the Life Insurance & Annuities Committee, often referred to as just the "A Committee".

Amongst other things, the NAIC discusses and develops laws, regulations and actuarial guidelines. The form of rule depends on the purpose of the rule and how the regulatory authority is executed. The development of these rules is done at the National Meetings (which occur four times each year) as well as through interim meetings and conference calls. While there are some exceptions, the approvals are done at the National Meetings. There are multiple levels of approvals. After an exposure period that typically lasts three months, LHATF will consider approving the rule. If approved by LHATF, then it goes to the A Committee for approval. Those two approvals typically happen in the same meeting. Lastly, it goes to Executive and Plenary for final approval. The final approval is typically at the next National Meeting, or three months after LHATF first approves the rule and six months after LHATF exposes the rule for comment.

As of the time of the writing of this article, the most recent NAIC National Meeting occurred September 9-12, 2002, in New Orleans, LA.

What's going on today?

The new CSO Tables are coming to fruition and include a 25-year select period, endowment at age 121 and lower rates overall. Insurers can expect lower basic reserves (both statutory and tax) as well as lower guideline premiums and more net amount at risk. Two reports are available from the Academy of Actuaries ("Academy") that discuss the development of the tables and many of its implications. To adopt these tables, the NAIC needs to approve a regulation which empowers its use. That regulation was approved by LHATF and is in exposure period for Executive and Plenary approval in December. Assuming Executive and Plenary approve the regulation in December, it will then need to be adopted by the states, which may take a few years. There are, of course, several details and intricacies of this adoption that are beyond the scope of this article.

There is an Actuarial Guideline (AG MMMM) in the works for Variable Annuity Guaranteed Living Benefits (VAGLB's). LHATF voted to expose the most recent version of the guideline, which provides guidance for setting reserves for these features. A fast-track December adoption may make the guideline effective for the end of this year. This Actuarial Guideline is considered a stop-gap measure, because the proper place to address these risks are in a capital context

continued on page 26

rather than valuation context. Consequently, the "C-3 Phase II" project will bring the modeling techniques of AG MMMM into a solvency framework.

With interest rates so low, the annuity writers have significant concerns with the existing annuity nonforfeiture law, which specifies a three percent minimum guarantee. Both the Academy and the American Council of Life Insurers have proposed alternatives that will provide for some indexing of that interest rate. While nothing is currently in the exposure period, this will likely move quickly due to the strain caused by the current economic environment.

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LHATF voted to adopt a new GRET Table for 2003, which is an expense table that some companies use to comply with the sales illustration rules.

While not an LHATF issue, the Life Liquidity Risk Working Group of the NAIC did adopt a prototype that will lead to more disclosure in the annual statements for stress liquidity risk exposures. This would apply to products such as GICs with bail-out provisions. The Academy also reported that an effective approach to regulating these risks is to circulate letters to the insurance companies requesting more information on the nature of the products that could lead to these risks. These letters are commonly referred to as "circular letters", and they can help lead to a worthwhile discussion of the company's risk exposure.

What can we expect tomorrow?

There is a regulation being considered (Reg XYZ) that will require minimum cash values for UL and VUL products that have long-duration secondary guarantees. Alternatives are being discussed and reviewed.

The Academy continues to push for a valuation and nonforfeiture environment that does not rely on specific, promulgated formulas. The Academy's position is that such formulaic approaches result in a continual volley of industry innovation followed by regulatory fixes. The Academy's position is that a context can be developed where the professionalism of the actuary can better accomplish the objectives of the valuation and nonforfeiture rules.

LHATF is also exploring revisions to the Standard Valuation Law that will retain the formulaic approaches for now but clean-up some other issues. Primarily, the proposals will remove deficiency reserves from the law and incorporate the actuarial opinion (currently a regulation) into the law. ☐

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Product Development Section Papers Competition

The Product Development Section is sponsoring a Papers Competition on the topic of "Product Risk and Its Management." This is open to all SOA members and provides awards for worthy papers of $5,000 for 1st place, $3,000 for 2nd place, and $1,000 for one or more 3rd place awards. All papers must be submitted by April 1, 2003.

Entrants must identify a type of product risk, fully describe it, and discuss its effective management. Product risk can be based upon: a **risk characteristic,** such as equity derivative risk or substandard/nonstandard mortality; a **product line,** such as annuities, variable annuities, variable universal life, or term insurance; a **market practice,** such as viatical settlements, lifetime settlements, and/or other secondary markets; a **basic requirement,** such as mortality or investment risk; or **any other product risk** you choose to identify.

Entries will be judged by a panel formed by the Section Council. Papers will be evaluated on the basis of originality, comprehensiveness, thoroughness, and practical applicability to product development issues. All papers must be available for posting on the Product Development Section web site; winning and other worthy papers will be posted. ☐

Entries must be submitted electronically to SOA's Life Fellow, Narayan Shankar, at *nshankar@soa.org*.