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Summary of the Life and Health Actuarial Task Force Meeting – September, 2003

by Larry Gorski

Annuity Nonforfeiture Work Group

Due to a scheduling conflict with the Valuation Actuary Symposium, the NAIC Life and Health Actuarial Force's (LAHTF) usual one-and-a-half day meeting was shortened to a single day. Friday's session opened with a status report from the American Academy of Actuaries Annuity Nonforfeiture Work Group. The work group is working towards the development of a regulation that implements the recently adopted NAIC Annuity Nonforfeiture Model Law.

The AAA Report focused on three issues: (1) identifying methods for disclosing the methodology used by the insurer to set the contract interest rate; (2) identifying acceptable methods for determining the reduction in interest rate to reflect the option values in equity indexed annuities; and (3) recommending actuarial certifications concerning the acceptability of the additional offset.

Four methods to deal with the disclosure issue were identified. The methods ranged for requiring a full and detailed description in the contract to no required disclosure. The LAHTF was asked to indicate a preference but no method was a clear favorite.

Two methods were suggested for demonstrating compliance with the requirements for the additional reduction in minimum nonforfeiture interest rates available to equity index option costs. The first method was based on evaluating contractual guarantees but without any discounting for voluntary withdrawal or annuitization. This method was called the "Book Value" methodology. The second method utilized current contractual values and required recognition of voluntary withdrawals and annuitizations. Regulators were not asked to choose between the methods but to provide comments concerning the acceptability of the two methodologies.

Due to time constraints, the draft recommended actuarial certifications were not discussed.

To obtain guidance from the LAHTF, two specific questions for LAHTF were raised by the AAA Work Group. First, what threshold, if any, should be used in the process for evaluating potential reductions due to option values? The thought is that the threshold would act as an "on-off" switch. If the methodology described above developed a reduction in excess of the threshold, a reduction up to 100 basis points could be used to set the minimum nonforfeiture interest rate. Otherwise, no reduction is permitted. Some sentiment for a threshold of 50 basis points was expressed but no consensus emerged. Second, what discount rate should be used to determine level annual option costs? LAHTF expressed a desire for a simple process for determining the discount rate. During the discussion, a question concerning the "as-of" date of the discount rate was asked but left unanswered.

NAIC staff will take the AAA Report and comments from the meeting and develop a draft Regulation. A conference call before the December NAIC meeting to further analyze the AAA Report and develop regulatory responses to the questions presented to LAHTF is anticipated.

New questions concerning the use of published Constant Maturity Treasury rate data to set the minimum nonforfeiture interest rate and ambiguities in the Model Annuity Nonforfeiture Law were identified in a memo from a regulator. These issues will be addressed by the AAA Work Group.

General Nonforfeiture Project

Next on the agenda was a status report from the AAA Nonforfeiture Improvement Work Group concerning the General Nonforfeiture Law project. The report identified four issues in need of regulatory input:

(1) How broad a scope should be considered for a general nonforfeiture law? All lines? Life & health? Life and annuity? Life only? Individual & group? Individual only? While not unanimous, the regulatory leaned towards starting "small," i.e. life and annuity.

(2) What is the proper balance between providing some form of equity versus comprehensive disclosure? Regulatory comments leaned towards the complete disclosure end of the range of choices.

(3) In what ways should nonguaranteed elements be addressed in any revision of the nonforfeiture law? Consistent with the regulatory view expressed to question two, nonguaranteed elements should be treated the same as guaranteed elements.

(4) What's broken in the current nonforfeiture law? A few regulators felt that in today's environment and current products, the current nonforfeiture is flawed in its entirety.

The AAA Work Group will utilize the input from the meeting to continue its work.

Reserves for Variable Annuities – the "Dollar for Dollar" Issue

The next item was the "hot topic" on the agenda. The LAHTF exposed for comment a revised Actuarial Guideline 34. The guideline states "While the method described in this Actuarial Guideline does not reflect future partial withdrawal activity, the appointed actuary must perform a standalone asset adequacy analysis of the variable annuity contract risks. Such analysis shall …"

The goal is for the NAIC to adopt the Actuarial Guideline at the December 2003 NAIC meeting. In order to accomplish this, LAHTF will be meeting with the NAIC A Committee in the near future to "get the ball rolling."

During the process of exposing the revised Actuarial Guideline 34, some interesting questions were asked:

(1) For variable annuities with Guaranteed Living Benefits, Actuarial Guideline 39 requires a standalone asset adequacy analysis. A natural question is, "What requirements apply to a variable annuity containing both a Guaranteed Minimum Death Benefit and a Guaranteed Living Benefit?"

(2) Should the revised Actuarial Guideline 34 contain a minimum future partial withdrawal rate or a floor formulaic reserve that includes future partial withdrawals?

While a preliminary response to the first question was discussed, everyone agreed that more research was needed before the question could be answered with authority. LAHTF answered the second question with a "no."

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Reserves for Variable Annuities with Guarantees – The Long Term Solution

The revised Actuarial Guideline 34 is considered the "short-term" solution to reserving for variable annuities with Guaranteed Minimum Death Benefits. The next agenda item was a report from the AAA Variable Annuity Reserving Work Group dealing with the "long-term" solution. The report started with a discussion of a timeline culminating in adoption by the NAIC of the new requirements at the December 2004 meeting. In order to meet the timeline, the AAA requested input on three questions:

(1) What form should the guidance take: Actuarial Guideline; Model Regulation under Section 9 of the SVL; or a new section in the SVL. LAHTF favored an Actuarial Guideline.

(2) Should the new guidance apply to inforce business at the effective date of the guidance? LAHTF leaned towards a "yes" response.

(3) What level of Conditional Tail Expectation (CTE) should establish reserve levels. The tentative answer from LAHTF was "65 percent."

For those actuaries following this issue, the NAIC Life Risk-Based Capital Working Group exposed for comment the latest Report including recommendations from the AAA dealing with the so-called C-3 Phase II project. The Risk-Based Capital C-3 Phase II and the LAHTF Reserving for Variable Annuities with Guarantees project are intimately linked in a coordinated effort to address an extremely complex issue. Unfortunately, the much awaited Alternate Factors were not ready for distribution and exposure. A more detailed summary of the NAIC Life Risk-Based Capital meeting appears at the end of the summary of the LAHTF meeting.

Credit Insurance Mortality Tables

LAHTF exposed for comment the July 2003 Draft Regulation concerning Credit Insurance Mortality Tables.

Other Items

The task force adopted a response to a question from the Financial Analysis Handbook Working Group concerning the use of certain financial ratios to determine the adequacy of reserves. The response contained the following statement: "The LAHTF members believe that these tests are of limited value ... the consensus is that the review of the actuarial memorandum is the only effective way in which the adequacy of the reserves can be determined."

LAHTF discussed the provision in the SVL for a reserve certification by the commissioner (Section 2 of the SVL). The LAHTF generally agreed that this requirement could be eliminated. LAHTF intends to review a number of issues concerning the SVL and after developing a position on each, produce an amendment that contains the complete collection of revisions. With this strategy, it may take a few years to finalize this project. The next item to be reviewed by LAHTF is the need for deficiency reserves in light of asset adequacy analysis.

The last item on the agenda was a status report from the AAA Illustrations Work Group. The project arose out of some questions concerning the use of flat multipliers in setting the mortality assumption underlying the Illustration Actuary's Reports. The AAA Work Group previously recommended a course of action involving increased education for illustration actuaries and revising the applicable practice note. The status report discussed efforts to have a couple of sessions at SOA meetings in 2004 and contained a draft question and response for inclusion in the practice note. The question deals with the use of a fixed multiple of the 1975-80 Basic Table to risk classes that, when combined, equate to the old standard class. The draft question is currently being reviewed by the AAA Work Group charged with revising the Illustration Practice Note.

Editor's note—see also an article by Tracy Polsgrove, chair of the AAA Work Group, in this newsletter.

Life Risk Based Capital Meeting

This meeting was dominated by the presentation of the Report from the AAA Life Capital Adequacy Subcommittee (LCAS) concerning "Setting Regulatory Risk-Based Capital Requirement for Variable Products with Guarantees (Excluding Index Guarantees)." The following significant changes from the December 2002 LCAS reports were noted:

(1) Variable life products were excluded while all variable annuities, even those without death benefits or living benefits, are included. Also included were insurance contracts that offer death benefit guarantees for specified investment funds.

(2) For purposes of modeling, the "working reserve" was set equal to the cash value. This is intended to simplify the modeling process.

(3) The calibration standards were modified.

(4) The risk measure was changed from modified CTE to CTE, and the modeling time horizon was changed to begin at time zero.

(4) The assumptions underlying the Alternate Factors for Guaranteed Minimum Death Benefits were finalized.

(5) An interest rate risk component for the guaranteed fund option was added.

(6) Insurers with guaranteed fund options within variable annuities are able to model their interest rate risk exposure as though they are not "exempt" from cash flow scenario testing.

Much to the disappointment of many interested participants in the process, the Alternate Factors and the Pre-Packaged Stochastic Equity Scenarios (10,000 scenarios for each of six asset classes) were not available for distribution.

The AAA Report was exposed for comment with the goal of having the recommendations adopted by year-end 2003 for implementation by 12/31/04.

Recommendations from the AAA LCAS concerning the treatment of the dividend liability addition to Total Adjusted Capital under modco reinsurance treaties and Worker's Compensation carve-out business were not acted upon by the NAIC Life RBC Working Group. ☐

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