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Update on NAIC Activities

by Larry Gorski

This report is being written midway between the Spring NAIC meeting held in New York and the Summer NAIC meeting. It will bridge the gap between the meetings by discussing the activities of the conference calls between the two meetings.

Some operational changes have taken place at the NAIC since the Winter 2003 NAIC meeting that may affect NAIC activities in calendar year 2004. The Life and Health Actuarial Task Force (LHATF) is now chaired by Leslie Jones (South Carolina) and the Life Risk-Based Capital Working Group has been merged into the Capital Adequacy Task Force, formerly called the Risk-Based Capital Task Force.

C-3 Phase 2 Project (Risk Based Capital and Reserves for Variable Annuities)

C-3 Phase 2 continues to move along the path to adoption for the year end 2005. At the March NAIC meeting, the American Academy of Actuaries (Academy) provided a status report to the LHATF on the progress of both the Academy RBC and reserving work groups. The Alternative Methodology factors for RBC were presented at the meeting. The factors for reserving purposes were released in April. The regulators exposed for comment the so-called "standard scenario" methodology. The standard scenario concept is being framed as a mechanism for putting a floor on aggressive actuarial assumptions and a tool to assist regulators when auditing an insurer's cash flow model. Different economic scenarios are proposed for RBC and reserves.

The LHATF had a conference call on April 12 to discuss the single scenario methodology. One of the major items of discussion was the use of the 10-year constant maturity treasury rate as the basis for the annual equity return assumption. Fund drop and return assumptions based on the 10-year constant maturity rate would be dynamic, in the sense that the standard scenario would change from valuation date to valuation date as interest rates change. Also discussed was the possibility of using a fixed equity drop and return as the standard scenario. The strengths and weaknesses of this approach were discussed without making any decision as to the best approach.

A second LHATF conference call occurred on May 13. The first hour of the two-hour call resulted in a tentative decision that the VA reserve requirement take the form of an actuarial guideline. A few regulators expressed concern that some insurers may challenge the enforceability of an actuarial guideline on the basis that the requirements go beyond CARVM and are "making new law." The next several items on the agenda were addressed in rapid-order fashion. The regulators agreed that the reserve requirements should apply to all in-force business, reserves should be calculated at the 65 CTE level, and, unless the Academy analysis of the Alternative Methodology identifies flaws, the Alternative Methodology would be acceptable. The regulators were supportive of a standard scenario floor, and they recognized that reserves could be calculated using models based on dates prior to the valuation date. The consensus view for the guideline's effective date was 12/31/05 with some type of phase-in.

The Academy's Variable Annuity Reserve Group Modeling Subgroup is evaluating the standard scenario concept and will report on its findings at the June NAIC meeting. While it is possible that the Academy C-3 Phase 2 RBC recommendations may be adopted at the June NAIC meeting for implementation at 12/31/04, a few remaining tasks need to be completed for that to occur. The Academy is working on recommendations concerning the content of the actuarial certification, requirements for documentation and modifications to the Modeling of Hedges section of the Academy C-3 Phase 2 September 2003 Report.

The NAIC's Capital Adequacy Task Force (CATF) heard a report from the Academy Life Capital Adequacy Task Force C-3 Phase 2 Work Group. After the presentation and

continued on page 20

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participation" and non-equity equity indexed annuities were given to the Academy work group. While the draft Annuity Nonforfeiture Model Regulation was not in its final version, it was deemed to be ready for exposure at the March NAIC meeting.

Nonforfeiture Improvement

During the March meeting, the LHATF had a lively discussion of the report from the Academy Nonforfeiture Improvement Work Group. One regulator argued that products with similar economic benefits should provide similar nonforfeiture benefits and that nonforfeiture benefits should not simply be driven by the classification of the product (e.g., universal life vs. traditional life). He also recommended that the Academy group considering a generalized approach to valuation work with the Academy Nonforfeiture Improvement Work Group.

The report identified three possible courses of action:

(1) Continue on the initial path and pursue a broad revision to the nonforfeiture law
(2) Narrow the scope to exclude components that may bring significant risk to the current tax status
(3) Defer general nonforfeiture revision until a time when the balance between benefits and risks is more favorable.

LHATF indicated a preference for the first approach. LHATF did not schedule any conference call before the June NAIC Meeting on this topic.

Disclosures Concerning Exposure to Liquidity Risk

At the March meeting, LHATF exposed for comment a recommendation to include additional disclosures concerning exposure to liquidity risk in the life company annual statement (2005). This issue was discussed during a conference call on April 26. The document exposed for comment at the March NAIC meeting with a minor addition was adopted by LHATF and sent to the NAIC Blanks (E) Working Group for their consideration.

The NAIC Capital Adequacy Task Force ("CATF")—Projects In Addition to C-3 Phase 2

In addition to materials related to C-3 Phase 2, the Academy Life Capital Adequacy Task Force was prepared to submit several recommendations at the March NAIC meeting but, because of time constraints, this did not occur. A conference call of the CATF took place on March 31 to discuss the remaining Academy recommendations. The Academy recommendations dealing with the following projects were exposed for comment by the CATF: treatment of preferred stock ("effect of notching"); treatment of dividend liability under modco reinsurance transactions; treatment of equity-indexed annuities in C-3 Phase 1; C-1 treatment of certain reinsurance transactions involving affiliated companies; additional RBC requirements for unauthorized reinsurance; and RBC treatment of guaranteed indexed separate account products.

The Life RBC Subgroup met via conference call on May 14. This call dealt with risk-based capital charges for Low-Income Housing Tax Credit investments (LIHTC). The basic idea is to report these investments in Schedule BA in a new category and include the guaranteed LIHTC investments with "Commercial mortgages-insured or guaranteed" and the non-guaranteed LIHTC investments with specific risk mitigants in the "All other in Good Standing" category for RBC purposes. The pretax RBC factors for these two categories are 0.14 percent and 2.60 percent respectively. Based on experience, the 2.60 percent RBC factor is adjusted by the Mortgage Experience Adjustment Factor. After a brief discussion, the subgroup decided to forward the proposals to the CATF at the June meeting. □

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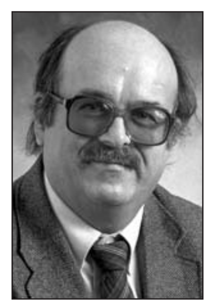

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