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Transitioning to the 2001 CSO—

State Adoption and Filing Considerations

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I expect the NAIC to adopt the model regulation for the 2001 CSO table in late 2002. The question then becomes: how quickly will states adopt the table? In the absence of a push by the insurance industry, there is a chance that there may not be 26 state adoptions in 2003.

Why might the industry not push for speedy adoption? The new table is not completely beneficial for the industry. Maximum allowable premiums will be lower under IRC Section 7702 and 7702A, and cost of insurance charges for universal life and variable universal life may have to be lower. If a state adopts the regulation next year, there is a four-year period until the regulation become mandatory (i.e., until 1/1/2008). If it takes until the following year (2004) to get 26 state adoptions, the three-year transition period will coincide nicely with the transition period for tax reserves (and, possibly, for 7702/7702A). [As an aside, because of the slowness of adopting the regulation, it is possible the industry will ask that the mandatory date be moved back a year (i.e., 1/1/2009)].

We don't have a good precedent for how fast the new table might be adopted. The 1980 CSO was a long time ago, had other significant changes besides mortality, such as valuation interest rates and required legislation. Florida is the only state that will require legislation to adopt the 2001 CSO. The rest of the states require only regulation adoption.

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One question is whether codification is a method effectively to get adoption in all states. There is a separate codification task force in the NAIC to add items to the "codification manual." Assuming that the model regulation gets adopted late this year, it is not unreasonable to expect the regulation to be added to codification next year. However, this is not considered sufficient to deem the regulation "adopted" by states. Most, if not all, of the larger states will want to act positively to adopt a regulation of this importance. Most states have not set themselves up to accept changes like this automatically via codification.

A logical question to ask is why the 2001 CSO is different than Regulation XXX, which everyone seems to believe *was* effectively adopted everywhere by codification. First, note that codification doesn't necessarily require that XXX reserves be calculated and held in Exhibit 8. It does require disclosure in the statement of any excess of codification reserves over reserves actually held, however, which many companies regard as an unattractive option. There is an argument that Regulation XXX is differently conceptually than the 2001 CSO regulation. Regulation XXX addressed a valuation issue that was not specifically covered by the Standard Valuation Law. Adopting a new table is different, because the Standard Valuation Law already specifies certain mortality tables.

It is expected that the ACLI, for purposes of measuring the 26 states for prevailing tax table status, will require positive action from each of those states.

There are still states that have not adopted the smoker-distinct or unisex versions of 1980 CSO, but which allow these products to be sold using these tables. However, there is a difference between a different version of table versus a brand new table.

Note that the new table covers nonforfeiture as well as valuation requirements, which is another reason why codification would not be sufficient to consider the table fully adopted.

Another item to consider is that the policy form typically names the mortality table used for nonforfeiture/valuation.

For valuation purposes, I believe this will be the situation during the transition period assuming that you have issued 2001 CSO contracts in some states that have adopted the regulation and 1980 CSO contracts in other states. If your state of domicile has not adopted the new regulation, you have to value all the contacts using 1980 CSO. If your state of domicile has adopted the new regulation, then:

• For the state of domicile filing, you use 2001 CSO for contracts with 2001 CSO basis, and 1980 CSO for contracts with 1980 CSO basis.
• For filing in a state that has not adopted 2001 CSO, you have to certify that reserves in aggregate meet that state's requirements, which includes valuing all contracts using 1980 CSO. If this requires higher reserves, you may choose to file a separate statement.

The new Actuarial Opinion and Memorandum Regulation which was adopted by the NAIC last year, was originally conceived as a way that an actuary could use state of domicile requirements for actuarial opinions, but the ultimate approach is cumbersome (the ACLI said they opposed the regulation as being nonhelpful), and would permit a commissioner to still require 1980 CSO. It may be slow to be accepted by many states.

Another issue that gets discussed with regards to transition is whether the state insurance departments will be able to handle the extra volume of product filings.

There may be a "crunch" at the beginning of the transition period for, say, term filings (although term filings are generally not that onerous). More likely will be a crunch at the end of the transition period, when a large number of permanent products are expected to be filed.

The ACLI has released a working draft proposal for an optional federal charter for life insurers. In a fact sheet the ACLI put together on "Regulatory Efficiency and Modernization," they contrasted the bank and securities firms who are able to get products to the national marketplace in 30-90 days with life insurers, who they say need six to 18 months. The ACLI is quick to note that a federal charter is just one optional track, and they also are pursuing making state regulation more efficient, which means working with the NAIC.

The NAIC has been trying recently to respond to "speed-to-market" issues. One effort here has been a trial program for the

Coordinated Advertising Rate and Form Review (CARFRA). Ten states participated in this pilot program, which provides a single point of filing and review, along with national standards for insurance products. So far, only one product, a term filing from Prudential last summer, has gone through the pilot. Term is the only individual life product currently in the pilot, but CARFRA is working on standards for UL.

However, slowness in developing product standards, and difficulty at getting all pilot states to agree to them, has dampened enthusiasm for CARFRA. Therefore, the NAIC recently announced a new effort to jumpstart the CARFRA process. They have created a new Interstate Compact Working Group to pursue developing and exposing for comment by June a legislative model for a national system to get products reviewed and approved.

In February, the ACLI submitted a draft to the NAIC of enabling language for commissioners to be able to participate in a natural system of product regulation.

So, it is possible that, by the end of the transition period, filings will be easier and quicker, but you may want to allow extra time for filings "just in case." □