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Summary of March 2009 NAIC/LHATF Meeting

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The March 2008 NAIC meeting was held in sunny San Diego. As usual, much time was spent on principle-based approaches (PBA) to reserves and capital issues.

Life Risk Based Capital: Philip Barlow ran a very good, succinct, RBC meeting from 5 p.m. to 6 p.m. on Saturday. A major accomplishment was to expose the RBC C-3 Phase III report. This would apply a PBA to life insurance capital, including in-force. There are some alternative methods mentioned, which would allow many companies to effectively opt to continue the current factor-based approach, but it will also allow other companies to begin using a more comprehensive PBA if they desire. Because of the options, I do not see a reason this should not be adopted for 2009 year-end. This document is being exposed and the RBC group will make a decision on it by the June NAIC meeting.

Life and Health Actuarial Task Force: The first action of LHATF was to welcome back the chair, Larry Bruning, who has had some health issues. He's feeling much better, and thanked everyone for their good wishes.

Updates on LHATF projects:

1. SVL2: The current exposure of changes to the Standard Valuation Law (SVL) was left exposed, to ensure that no other wording tweaks were needed. It is expected that this could be voted on via an interim

conference call, and sent up to their NAIC parent committee shortly.

2. Valuation Manual: Much of the LHATF meeting was spent reviewing the work of the LHATF subgroups working on various sections of the Valuation Manual:

a. VM-00, 01: Mike Boerner heads the LHATF team on this part of the Manual (as well as heading the Academy team on the Valuation Manual in general). These sections of the Valuation Law on Process and Coordination are exposed. There is some additional tweaking of wording expected. In addition, there is an Academy project, headed by Alice Fontaine, to develop a pros and cons document on various scope alternatives (e.g., should PBA apply immediately to all life products, only to term and UL with secondary guarantees, should there be phase-ins?). Alice gave a report at this LHATF meeting, and expects to have a more detailed report in the next few weeks.

b. VM-20: A large portion of the LHATF meeting was spent on VM-20, which gives the requirements for life insurance. Pete Weber heads this effort for LHATF, and has done a masterful job getting through the document and virtually all the proposed amendments. There are a few open issues, and much of LHATF's time at this meeting was taken up on these. Pam Hutchins presented an Academy recommendation to allow scenario reduction techniques when stochastic scenarios are required. One

big open issue was how to come up with a net asset earned rate; Gary Falde and Alan Rothenstein head an Academy group that has developed a potential methodology that LHATF could use to set default rates and effectively limit the asset rates assumed in modeling for reserves. This will be discussed further on a conference call, but it looks like a very workable solution. John Bruins gave an ACLI presentation on a net premium approach for life reserves, which is proposed because of tax reserves considerations. This proposal is not in final form; this is likely the big remaining open issue at this time.

c. VM-20, Reinsurance: Sheldon Summers heads the LHATF subgroup on reinsurance, as well as heading the Academy group on the same subject. One open issue is how reinsurance should be handled under PBR: if the ceding company has to calculate both a reserve gross of reinsurance and a reserve net of reinsurance, how will it be done, considering that the reinsurer and ceding company may not be valuing the business in the same manner? A conference call is being scheduled to finalize this issue. A second issue is whether credit can be taken in PBR reserves for reinsurance treaties that do not pass-on all the risk, e.g., one that reinsures just the secondary guarantee on a UL with secondary guarantee. This issue would likely involve changing the reinsurance regulation—VM-20 would not need to be held up pending resolution on this.

d. VM-21: This section would simply bring in the Variable Annuity CARVM Actuarial Guideline, which goes into effect at year-end 2009. The guideline is obviously already written, so this would simply be a matter of making sure it is in the right format.

e. VM-25, 26: These are the health sections. Julia Phillips headed this group. At this time, there are no changes expected to the health reserving requirements. These sections codify the current plans, and are complete.

f. VM-30, 31: Katie Campbell heads this effort on PBR reporting and review. There is a bit of wording being looked at regarding the actuarial opinion, but otherwise, VM-30 looks like a wrap. VM-31 has been tracking the requirements of VM-20, but also looks to be in reasonable shape.

g. VM-50, 51: Fred Andersen is heading this effort on PBR Experience Reporting. He reported that New York is getting close to issuing an RFP for reporting mortality experience; this reporting is specifically needed to satisfy a condition of using the current interim preferred mortality tables on the 2001 CSO. This experience can be used to see whether any additional changes are needed to the VM sections. There will probably be some sort of exemption for smaller blocks of business.

In summary, the Valuation Manual is quite close to being a reasonable draft that can be passed on to the parent committees of LHATF. It is not, nor is it ever expected to be, final (i.e., new product lines are expected to be added, and other changes to rules are expected to be made as new facts become available over the years).

3. Mortality: There were several mortality projects discussed at LHATF:

a. Preferred Mortality—new CSO?: Tim Harris gave an update on the joint SOA/AAA project on preferred mortality. The mortality since the 2001 CSO has been issued has noticeably improved. There was an open question as to whether there should be a 2008 CSO. Tim Harris' group did some analysis, which showed that, if a company was using the 2001 CSO tables without the interim solution splits, there would be a noticeable reduction in term reserves, with a lesser reduction in whole life reserves. However, if a company were using the interim tables, the differences in reserves were much smaller. LHATF is going to conclude this matter on a conference call. They have requested that the AAA/SOA group do additional analysis comparing the basic mortality differences between the 2001 and 2008 tables.

b. Underwriting Criteria Score: For the PBA project, it is still anticipated that companies without credible experience would need to rely on the Valuation Basic Tables as developed by the SOA, using underwriting criteria scores to determine which tables to use. It was announced that the debit/credit methodology to figure out the underwriting criteria score is in its final stages of review, and should be on the SOA Web site.

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c. Simplified Issue/Guaranteed Issue Mortality: LHATF has asked the SOA/AAA to determine a reasonable mortality basis for simplified issue and guaranteed issue plans. The concern is that the 2001 CSO may not be sufficient. The SOA/AAA group will look at this, with Mary Bahna-Nolan leading this effort.

d. Individual Annuity Mortality: The SOA is also putting final touches on the report on individual annuity mortality. At LHATF's request, the SOA/AAA will be developing new Valuation Tables for Individual Annuities. The Individual Annuity mortality has shown marked improvement, particularly for the larger annuity payout amounts. Mary Bahna-Nolan will also be leading this project.

4. Capital and Surplus Relief: LHATF has been charged with fast-tracking the Capital and Surplus Relief items that were proposed last year due to the economic turmoil, but ultimately not enacted because the industry did not prove that there was a dire emergency. Therefore, LHATF exposed the three documents that they had agreed to on this matter: Known as

proposal 1a (the proposal to allow the 2001 Preferred tables to be used for all 2001 business, even if issued prior to 1/1/2007); 1c (which clarified that the preferred smoker/non-smoker tables can be used in determining segments); and 2 (which allows X factors for deficiency reserves to go below 20 percent, and that the X factors can decrease by duration).



5. Standard Nonforfeiture Law: Work continues on modernizing the Standard Nonforfeiture Law. John MacBain is leading this effort. In addition, there was a discussion on whether changes that are proposed to the current nonforfeiture law to accommodate PBR need to be revised to ensure proper tax treatment. The ACLI is looking at what wording changes they recommend.

In summary, PBA has made significant progress over the past couple of years. It seems quite likely that PBA will expand into the RBC arena soon, and that PBA reserves, at least for some products, will be adopted by the NAIC this year, to be brought before legislatures in the next couple of years. □

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