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NAIC Update – March 2010 Meeting

By Donna R. Claire

The March 2010 NAIC meeting was March 24 to March 28, 2010 in Denver. (Note to meeting planners—it can still snow a lot in March in Denver! Some flights were canceled and some interstates closed as up to a foot of snow accumulated.)

The remainder of this article summarizes my notes on the meetings I attended, or reports from friends and colleagues:

Life and Health Actuarial Task Force

Larry Bruning started the meeting by stating the goals—to make further movement in the principle-based approach to reserves. The goal was to finish certain items at this meeting, and to have conference calls to potentially vote on the Valuation Manual before the next NAIC meeting, which is in August. Larry mentioned that there are four major areas where there is still work needed: these are the net premium approach being worked on by the ACLI; more work on margins; asset issues including assumed spreads on reinvestment; and mortality.

Valuation Manual

As with the last Life and Health Actuarial Task Force (LHATF) meeting, much of the meeting was spent reviewing the work of the LHATF subgroups working on various sections of the Valuation Manual:

- a. **VM-00, 01, Process and Coordination:** 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). One issue is determining the scope of the Manual from day one—it appears that the answer may be a simple test to determine which life insurance products shall be covered and which will be excluded from the Manual. Variable annuities are in, while fixed annuities will not make the 2009 Manual. There is still work to be done on definitions that is expected to be completed in the next couple of weeks.
- b. **VM-20, Life:** Pete Weber heads the LHATF group on VM-20. Pete has had numerous conference calls on VM-20, and most of the work

on this part of the manual has been completed. A number of issues were discussed at LHATF. There was a discussion on what products shall be included—the group has developed a test that determines which products would be included from day one. If the product fails the test, reserves will default to the current CRVM methodology. An updated version of VM-20 was exposed.

- c. **VM-21 Variable Annuities:** This section will bring in the Variable Annuity CARVM Actuarial Guideline, which became effective at year-end 2009. This section is ready for the initial Valuation Manual.
- d. **VM-25 and VM-26:** VM-25, the health section that essentially continues the current rules for health insurance, is now finished. The VM-26 section on credit insurance has been completed and was adopted for the initial Valuation Manual.
- e. **VM-30, 31, PBR Reporting and Review:** Katie Campbell heads this effort. VM-30 has already been adopted for the preliminary Valuation Manual. A new version of VM-31 was exposed for comment.
- f. **VM-50, 51, PBR Experience Reporting:** Fred Andersen is heading this effort. The ACLI has requested that data collection should be used to create an industry table, but individual company data should come directly from companies. Updated drafts on these documents were exposed for comments.

Related Issues

There were a number of topics discussed at LHATF, most related to SVL and the Valuation Manual. These include:

PBA Overview: I gave a brief presentation on behalf of the Academy's Life Practice Council and Life Financial Soundness/Risk Management Committee. I stated that although we continue to support PBA, we



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have concerns that the PBR project is deviating from its original intent, with an abundance of rules and margins being considered.

Preferred Mortality: Tom Rhodes gave a report on credibility, based on a study he had done on behalf of the SOA. Note that this report is available on the SOA website (www.soa.org). He also referred to the PricewaterhouseCoopers (PwC) study performed for the SOA, which is also available on the SOA website. The studies will be important for the determination of assumptions such as mortality under PBA. Tom stated that one needs margins because of random fluctuations, and for the misestimate of experience assumptions. Mary Bahna-Nolan provided an update on preferred mortality work performed by the Academy of Actuaries and Society of Actuaries. Mary suggested that revisions be made to the VM-20 section to remove the requirement to tie the mortality assumptions to a CSO table. Mary stated that they are working to incorporate credibility work into VM-20. One open question is how to state a margin on mortality assumptions without raising tax issues. Mary also mentioned that the group is continuing to target 2012 for a new mortality table.

Payout Annuities: Mary Bahna-Nolan provided an update on the joint SOA/Academy group. The group is looking at developing a new valuation table. The experience study portion has been completed. The SOA/Academy group is working on applying proper loads to the experience, including an improvement scale in the valuation table. Note to companies in this market: the annuitant mortality has improved dramatically, particularly at larger sizes. This should be considered in annuity product development.

Guaranteed/Simplified Issue: Mary Bahna-Nolan gave an update on a new SOA/Academy group that is

looking to develop new valuation tables for guaranteed and simplified issues. A survey on these products has been sent to companies to determine how to best approach this project.

Net Premium Approach: John Bruins continued discussing the net premium approach to PBA reserving, which the ACLI states is needed for federal income tax deductibility of reserves. The ACLI has submitted some proposed changes to VM-20 to handle the net premium approach. Note that this is the biggest open issue on the life insurance PBA reserves.

RBC C3 Phase 2, and Actuarial Guideline 43: The consulting firm Oliver Wyman provided a presentation on its observations regarding VA statutory accounting results. One observation was that companies with established hedging programs were seeing an impact on statutory results that was not intuitive. As a result some companies may have modified some of their hedging strategies to provide better statutory results, even though such modifications may have not been optimal with respect to hedging for the underlying risks. Other observations were that the AG43 standard scenario was the dominant reserve for a majority of companies (as of 12/31/09), that the AG43 standard scenario has opposing and decreased interest rate sensitivity as compared to the stochastic results, and that aggregate reinsurance produced strange reserve patterns in the standard scenario. Oliver Wyman stated that it was premature to make any recommendations until further study was undertaken. The firm expects to publish a paper next month on its findings and to follow that with educational seminars. *(Editor's Note: This article was written at the time of the March NAIC meetings. The aforementioned paper may be published before this issue's publication date.)*

Economic Scenarios: Fred Anderson heads a group examining economic scenarios. The group has changed the ultimate mean rate compared to the Academy's work. (Note that Nancy Bennett heads the Academy's Economic Scenarios Implementation Work Group, and has an updated scenario model that is on the Academy's website.)

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Prescribed Default Costs to be used on Existing Fixed Income Investments: Gary Falde and Alan Routhenstein gave an update on the work on prescribed spreads. They provided an amendment to VM-20 to cover these changes.

Margins: LHATF reversed an earlier decision, and determined that specified margins are not needed for any assumptions other than mortality. For other assumptions, guidance already exists in the Manual that conservatism should be considered, particularly for uncertainty.

Updates to the Standard Nonforfeiture Law: John MacBain gave a brief update on this group. A draft report has been sent to the Academy's tax working group. A report will likely be made available to LHATF in the next few months.

Actuarial Guideline 25: John MacBain gave an update on the Academy's work on Actuarial Guideline 25. This guideline discusses nonforfeiture for pre-need contracts, making some exceptions to rules for these small policies. They recommended the limit for these exemptions be increased to CPI—increasing the \$10,000 threshold for the exemption up to \$16,875 for this year. LHATF voted to expose the Academy's version of the changes to Actuarial Guideline 25 for 30 days.

Federal Health Bill Update: There was a presentation on the Federal Health Bill by Brian Webb, from the NAIC. He stated that:

- The NAIC is to develop a report in 2010 to create a uniform definition of items that go into the calculation of the Medical Loss Ratio (MLR) and to create a standardized methodology for the calculation.
- Rebates will be required if the MLR is not met.
- The Treasury was not given the authority to approve rates, but it will monitor rates.
- The Secretary must come up with a National Reinsurance plan for early retirees. There will be a requirement for payments into a fund, and each state is to determine how it will collect funds. The NAIC is to help develop risk corridors and profiles.



- Grandfathering: the new rules will not apply to existing plans.
- Rates must be based on the entire book of business and cannot be based on each plan separately.
- The NAIC expects that LHATF, and particularly the Accident & Health Working Group, will play a major role in helping the NAIC develop models and reports.

Life Risk Based Capital Working Group

Philip Barlow ran the RBC meeting held on March 25, 2010. The RBC C3 Phase 3 implementation was delayed until 12/31/11.

The ACLI is addressing basic and intermediate hedges in the work it is doing regarding a Derivatives Risk Mitigation Proposal.

The ACLI sent out an update on March 24 with respect to commercial mortgage loans. It expects to complete a study and produce a final report by the end of the third quarter of 2010.

Fred Andersen presented the report from the Casualty Actuarial Task Force (CATF) C3 Phase II Results Subgroup. Fred reported the subgroup's five main observations, and suggested that conference calls be

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scheduled to discuss them in detail. The five observations include: results were lower than expected; documentation did not provide enough information to assess the quality of the numbers; companies were inconsistent with respect to the setting of key assumptions; the TAR calculation is very volatile; and companies that did not choose to take credit for risk mitigation programs did not provide any documentation regarding such programs.

Solvency Modernization Initiative

The Solvency Modernization Initiative (SMI) group is a new Commissioner level group based on an NAIC initiative to examine reserves and solvency on a broad basis, also considering what is happening globally. The PBR (EX) group, which is charged with shep-

herding the PBA project through the various NAIC Committees, is a subgroup of this group. The SMI had a number of meetings in Denver. Unfortunately they coincided with the LHATF meetings, so I was unable to attend. However, these meetings have promoted good discussions on some fundamental issues, e.g., what is the purpose of regulatory capital? The work of the solvency modernization initiative group may have a significant impact on companies in the future, so it will be an interesting group to monitor.

Summary

In summary, PBA has made significant progress over the past couple of years—we are hoping the finish line will be reached soon! ▣

NEW REPORT:

COST OF IMPLEMENTING A PRINCIPLE-BASED FRAMEWORK FOR DETERMINING RESERVES AND CAPITAL SURVEY RESULTS

Review the results of a survey on life insurer perspectives and preparedness levels for implementing a principle-based framework for determining reserves and capital. Forty-eight companies participated in the study and offered insight into the stages of their planning, expected cost levels and concerns for implementing the new approach. The report also details additional observations Towers Watson obtained through follow-up interviews with some of the study participants.

View the report today at <http://www.soa.org/pbasurvey>.