Risks and Rewards Newsletter

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RISKS and REWARDS

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Call for Authors!

Risks and Rewards needs your help. We have some ideas for future articles but are in dire need of authors. Some ideas we have are:

- Review of Professor Richard Thaler's speech (author of "The Winner's Circle") at the Investment Section breakfast at the Annual Meeting. If you are going to be at the breakfast, please volunteer.
- Financial Patents. There have been new patents issued on financial topics, including one to an actuary and former Section officer, Meyer Melnikoff. This article would discuss financial patents in general and review the specifics of one or more patents. Richard Wendt, co-editor of *Risks and Rewards*, has the patent details from the U.S. Patent Office. If you are interested in authoring such as an article, please contact Mr. Wendt at his *Directory* address.
- Review of *Financial Economics*, the new text published by the Actuarial Foundation. Two articles would be appropriate to cover the breadth of this topic.

If you would like to volunteer for one of these topics, or have other ideas for articles, please contact one of the co-editors listed on page 2.

Synthetic GIC and Guaranteed Separate Account Model Regulations

by Victor Modugno

Two new model regulations—one covering synthetic GICs and the other guaranteed separate accounts—are working their way through the regulatory process. Both were on the agenda of the 1998 NAIC summer meeting held in Boston in June. A working group under the Life Insurance (A) Committee is developing the Synthetic GIC regulation. Action on adapting a proposed model regulation was deferred until the fall meeting due to controversy over several provisions in the latest draft. A working group under the Accounting Practices and Procedures (EX4) Task Force is developing the guaranteed separate account regulation. A revised model regulation was exposed for comment. Both regulations are available on the NAIC web site (naic.org). The web site also has contact persons for comments.

Most regulators in the working groups and industry representatives of the interested parties are the same for these two regulations. The main difference between these two products is whether the assets subject to guarantees are held in a trust (synthetic GIC) or in an insurance company separate account. The reason for different working groups is that separate accounts are subject to an accounting standard (*SSAP 89*), which governs accounting and reserving for separate accounts. There is no accounting standard for synthetics.

Industry groups developed initial drafts of these model regulations based on existing separate account and synthetic GIC regulations—New York Regulation 128, California Insurance Code Sections 10506.4 and 10507, and Bulletins 95–8 and 95–10. Reserves were based on guaranteed values discounted at 1.05 of treasury spot rates while market value of assets were reduced by asset valuation reserve-based factors. The synthetic GIC regulation had several required contract provisions, which seemed unusual because the purchasers of these contracts are large institutions that are represented by attorneys and other experts. Mandated contract provisions are not needed for consumer protection.

These drafts then went to the regulatory task forces. There were several conference calls and redrafts. Many of the ideas developed by the synthetic group were incorporated into the separate account regulation. The revised filing requirements were of greatest concern to the industry group. In the

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original draft, a company would need to get approval of plan of operation in its domiciliary state. So long as that state had requirements similar to the model regulation, other states would accept this determination. Previously approved contract forms would be grandfathered. In the latest draft, approval of the plan of operation would be required in each state in which the insurer wants to issue contracts and grandfathering of existing contracts is limited.

The synthetic GIC regulation was further along in development and elicited the most comments from industry representatives prior to the Boston meeting. Most letters expressed concern about the filing requirements and the actuarial opinion and memorandum. A letter from the Stable Value Association opposing the filing requirements indicated that buyers prefer efficient and effective regulation. According to that comment letter, these regulations are out of line with the current free market, deregulation trend for sophisticated purchasers. Another area of comment was competition with banks. Banks in the synthetic business can negotiate contracts with clients without getting advance approval. Bank regulators focus on internal risk management and controls of these and other businesses of the bank using sophisticated value-at-risk measurements. Others commented that only the domiciliary state had all the information needed to assess solvency. State insurance departments should use their limited resources where they can add the most value—in monitoring overall solvency of domestic insurers and protecting unsophisticated consumers from abuses.

Consider the typical separate account or synthetic GIC sale. A GIC manager, who specializes in purchasing these contracts, requests proposals for a large 401k-plan client or a pool of smaller clients. This manager has investment professionals, credit analysts, and attorneys with substantial experience in these arrangements. The insurer or bank issuing the contract must be large, double-A rated, and have appropriate staff to pass the GIC manager's due-diligence. Issuers who are allowed to bid are concerned about protecting their capital and preserving their high ratings from Moody's and S&P, which are needed to remain in this business. They also have a group of experts in this field, including attorneys, investment professionals, and underwriting and product experts. The potential abuse of this product by a small-unrated insurer or unsophisticated buyer could be controlled through the financial qualification requirements to issue or purchase these contracts.

Because of objections raised during the Boston meeting, action on adopting the synthetic GIC model regulation was deferred until the next meeting. Meanwhile an industry group is trying to organize united opposition to some of the more burdensome requirements of the proposed regulations.

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This newsletter is free to Section members. A subscription is $15.00 for nonmembers.
Current-year issues are available from the Communications Department.
Back issues of Section newsletters have been placed in the Society library.
Photocopies of back issues may be requested for a nominal fee.

Actuarial Principles of Asset-Liability Management

The ALM Principles Task Force of the SOA, chaired by Mike Hughes, has completed a second draft version of Actuarial Principles of Asset-Liability Management. The task force welcomes your comments and suggestions. The draft document can be downloaded from the SOA Home Page/Libraries/Finance and Investments/ALM Principles. You may also request a hard copy by contacting Cherie Harrold at 847–706–3598.

Please provide any comments or edits on the draft Actuarial Principles of Asset-Liability Management to Kevin Long via e-mail at klong@soa.org or fax at 847–706–3599.