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LHATF Exposes Revised Regulation XXX

The following are excerpts taken from the newsletter of the National Alliance of Life Companies (NALC) and are reprinted with permission.

Is it possible that the NALC version of the amended Regulation XXX will be adopted in 1998 by the NAIC? Mindful of the looming crisis in the term insurance market, the Life and Health Actuarial Task Force (LHATF) exposed the latest proposal from the Ad Hoc Industry Committee on "XXX" (AHIC) organized by the NALC in August 1997. The regulators also committed to a schedule which would have LHATF and the "A" Committee adopting "XXX" by October 5, 1998. At that time, it would go to the Executive Committee for consideration at its interim meeting. If all goes well, the NAIC Plenary could adopt XXX at the Orlando meeting in December.

Timeline

The following timeline is anticipated if everything goes well for the adoption of "XXX."

1. Adoption by LHATF by conference call — October 5.
2. Joint adoption by LHATF and (A) Committee — October 5.
3. To Executive Committee — October 5.
4. Adoption by Executive Committee before December NAIC meeting.
5. Adoption by Plenary — December 6.
6. Adoption by states — 1999.
7. Effective date — January 1, 2000.

Proposal Overview — Applicability

This regulation potentially affects **all** life insurance policies, **with or without** nonforfeiture values. The following types of policies, however, are **not** subject to the regulation:

1. *Reentry policies* — Policies which are reentries from policies issued prior to the effective date are not subject to the regulation. There are conditions that the reentry policies must meet in order to be exempt.
2. *Universal life policies with short secondary guarantees* — Universal life policies which meet the following conditions are exempt:
   a. Secondary period (if any) is five years or less.
   b. Premium for secondary guarantee is at least net level premium.
   c. Initial surrender charge is at least the premium for the secondary guarantee.
3. Variable life insurance
4. Variable universal life insurance
5. Group life insurance — Unless provides for a stated or implied schedule of maximum premiums for more than a year.

Basic Reserves

Traditional "humpback" reserves are held for each level-premium segment. A "humpback" reserve is a traditional term reserve for the duration of the segment. At the end of the segment, the terminal reserves will normally return to zero.

The end of a level-premium segment is determined when the percentage increase in guaranteed premiums is greater than the percentage increase in valuation mortality. For a normal 5-year renewable term policy, there would be a series of 5-year, level-premium segments.

Unitary Reserve Test

Unitary reserves, if greater, must be held instead of the traditional "humpback" reserve. For unitary reserves, net premiums are calculated as a constant percentage of guaranteed premiums for the life of the policy. For the 5-year renewable term policy, the net premiums would be a constant percentage of the lifetime schedule of guaranteed premiums.

Valuation Basis

The valuation interest rate for "XXX" reserves is the same as is used for other CRVM reserves. A full CRVM expense allowance may be taken in the "humpback" reserves for the first segment and for the unitary reserves. All currently acceptable versions of the 1980 CSO Table may be used for the mortality basis. In addition, the regulation provides for the use of new mortality 20-year selection factors. These factors may only be used during the first segment.

Deficiency Reserves

Traditional deficiency reserves must be calculated for all policies subject to this regulation. A deficiency reserve is defined as the excess of minimum reserves, if any, over basic reserves.

Minimum reserves are calculated using the lesser of the guarantee gross premium or the calculated net premium. The method of calculating the net premium is the same as that for basic reserves, except for the valuation mortality table.

Deficiency Mortality Table

A company may use a mortality table eligible to be used for basic reserves with no restriction. Alternatively, the company may choose to select a more aggressive table. This table uses the 20-year selection factors provided for basic reserves. The valuation actuary may multiply these selection factors by any ratio (X), subject to the following:

1. X may vary by policy year, policy form, underwriting classification, issue age, or any other policy factor expected to affect mortality experience.
2. X must be at least 20%.
3. X cannot decrease in any policy year.
4. The present value of future death benefits using the resulting valuation mortality, just be at least as great as the present value of future death benefits using anticipated mortality experience.
5. The resulting valuation mortality must be greater than the anticipated mortality experience during each of the first five years after the valuation date.
6. X must be increased anytime it is necessary to meet all these tests.
7. X may be decreased anytime as long as it continues to meet all these tests.

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8. If a ratio less than 100% is used for any policies, the company must comply with the following:
   a. An actuarial opinion based on asset adequacy analysis (Section 8) must be prepared for the company.
   b. The appointed actuary must annually opine as to whether X meets the requirements of this regulation.

Universal Life

For the purposes of this regulation, universal life policies with secondary guarantees must hold the greater of reserves calculated by this regulation and the reserves required by CRVM for universal life policies. Secondary guarantees are provisions in universal life policies that allow a policy to remain in force, even though the current surrender value (or in some cases, account value) is negative. These provisions usually allow the policyholder to pay a minimum premium to guarantee the policy does not lapse. To calculate the "XXX" reserves, the secondary guarantee periods are viewed as a term policy within the universal life policy. The same calculation rules are used for these policies as are described above.

Other Provisions

1. Minimum reserves. When all the calculations are completed, the company must still hold at least 1/2c, or the "cost of insurance" to the paid-to date, depending on the valuation method.
2. Unusual patterns of guaranteed surrender values. Additional reserves may be required if the scheduled premiums are not sufficient to fund future guaranteed increases in surrender values.
3. Optional exemption for YRT reinsurance.
4. Optional exemption for attained age YRT policies.
5. Exemption from unitary reserves for certain n-year renewable term policies.
6. Exemption from unitary reserves for certain juvenile policies.

Effective Date

The regulation will be effective for policies issued on or after January 1, 2000.

Changes Overview

The following are changes that were made to the "XXX" regulation (95 Reg) as adopted by the NAIC for this proposal:

1. The 5-year safe harbor was eliminated. Universal life policies which meet certain requirements are exempt.
2. The selection factors were updated. The 95 Reg had 15-year selection factors based on experience for the years 1983–1986, loaded by 50%. The proposal uses 20-year selection factors based on the same experience, improved for 15 years, then loaded by 50%. During the last five years, and at older ages, the rates were graded into the 1980 CSO Table.
3. New deficiency mortality standard. The 95 Reg used the same mortality as for the basic reserves, loaded 20% instead of 50%. The proposal relies significantly more on the professional judgment of the appointed actuary. A company will be permitted to multiply the selection factors by ratios that are as low as 20%. *Please note: There are several requirements which must be met, however, including the filing of a Section 8 opinion and an annual opinion on the resulting valuation mortality.*
4. YRT reinsurance exemption limitation. The ceding company will be limited to a reinsurance reserve credit no greater than the reserves held by the assuming company. This only applies to policies for which the assuming company elects this exemption.
5. Effective date. Changed from an uncertain date in the 95 Reg to January 1, 2000, in the proposal.

Status in the States

Wisconsin
The state of Wisconsin has adopted the 95 Reg with an effective date of January 1, 1999. If specific action is not taken by the Wisconsin Department of Insurance, this will be the effective date in Wisconsin.

Representatives from the Wisconsin Department of Insurance were present at the LHATF meeting in New York. They have expressed a strong willingness to consider the proposal for Wisconsin, if they can be confident of a 1998 adoption by the NAIC. It is hoped that they will accept the (A) Committee's adoption on October 5 as sufficient evidence to move back the effective date for Wisconsin. The following is an outline of possibilities for outcomes in Wisconsin if the regulation becomes effective on January 1, 1999:

Companies *licensed* in Wisconsin, even if they do not sell term in the State, but sell it in other states, will be subject to the regulation for business written in *all* states. As result it is likely that many companies will immediately reduce initial premium guarantees for *all* states to five years. This may lead unaffiliated companies to discontinue writing term insurance

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in *all* states until products can be modified and supported administratively. Larger companies will likely continue to write products with longer guarantees using affiliated companies not licensed in Wisconsin. There would likely be a large, immediate reduction in consumer choice for term insurance in the country.

It is unclear whether Wisconsin will adopt the new proposal with the January 1, 2000, effective date. It is still possible that they could adopt the proposal with a January 1, 1999, effective date. Unfortunately, this will yield similar results as adopting the 95 Reg on January 1, 2000. The only difference is that companies will eventually move the guarantee periods out from five years.

The only possibility for a reasonable transition from the current term market to the one which will develop after the adoption of "XXX" is adopting the Proposed Effective date of January 1, 2000. Companies will have all of 1999 to develop products that are priced to reflect the costs of the new valuation regulation. If several states adopt the regulation with a January 1, 2000, effective date, larger companies will not be able to circumvent the regulation by avoiding states that have adopted the regulation.

Many companies, including several Wisconsin domestics, can be expected to urge Wisconsin to move back the effective date to January 1, 2000.

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- How is the financial educator/advisor compensated?
- How does the program provide ongoing education to all employees?

Employee Financial Education: The Time Is Now

I believe the time for employers to implement financial education programs is now. Consider one final factor. The implications of individuals not prepared for a secure financial future are tremendous. If employers and the benefits industry in general do nothing, the magnitude of this issue will soon dwarf any other societal issue. The government will have to impose solutions on employers. It doesn't take a long history lesson to remember changes in our nation's overall health care system were almost mandated on employers. The same could happen in five or ten years in regard to employees retirement funding, college funding and other financial educational needs. This leaves a window of time for employers to jump in and provide financial education to employees on their terms as opposed to terms mandated from Congress. Properly designed financial education programs can help employees take financial stumbling blocks and turn them into building blocks. As we draw near the year 2000, the proactive employers will lead the way into the new millennium.

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