Small Talk Newsletter

May 2001 – Issue No. 17

The Status of Proposed New Actuarial Opinion and Memorandum Regulation

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Introduction

When an actuary renders an opinion on the reserves of an annual statement, sometimes he also develops an actuarial memorandum describing an asset adequacy analysis. This is governed by the AOMR (Actuarial Opinion and Memorandum Regulation). Based on the company size in net admitted assets and on various ratios (annuity reserves to net admitted assets, capital and surplus to the sum of cash and invested assets and noninvestment grade bonds to capital and surplus), smaller companies may have to perform this analysis and develop a memorandum.

The current AOMR requires annual analyses for companies over $500 million in assets and triennial analyses for companies over $100 million in size. Others can be completely exempt by staying within the ratios.

This has been a bulwark of the regulatory environment for the past decade. At the March meeting of the National Association of Insurance Commissioners (NAIC), the Life and Health Actuarial Task Force (LHATF) accepted two minor revisions to the revised model and forwarded it to the (A) Committee, which considers life insurance issues. That committee will hold the model until the June meeting when it is likely to pass. If so, it will go to the Executive Committee and then the Plenary for final adoption.

In the December issue of *small talk,* I wrote an article discussing the history.

This explained how the regulators got to the point of significant revisions. To encourage smaller company actuaries to consider the significance of this, our Section posted a summary of concerns as well as the revised model on our Web site.

History:

To refresh people's memories, some of the previous history is summarized. Over the years, regulators have been concerned that, with innovative products and newer asset types, some companies could be participating in risky behavior and not have to do any analysis. The current regulation has specific rules for exemption and only addresses the amount of annuities — not UL or other products like equity-indexed life. From time to time, efforts have been made to refine this.

Last year at the March meeting, the regulators decided to develop a revised AOMR. At the September (third quarter) meeting, they put an official proposal on the table for exposure.

Outline of changes:

One major change is the elimination of the exemptions based on size and the ratio tests. Under *Purpose,* it mentions giving the requirements for a statement of actuarial opinion and memorandum. Formerly, it referred to guidelines and standards. Under *Scope,* it allows the appointed actuary to use professional judgment in performing the asset analysis and developing the opinion and memorandum consistent with relevant ASOPs (Actuarial Standards of Practice). "However, the commissioner shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in his or her judgment, these specifications are necessary for an acceptable opinion...." A memorandum shall be required each year

Under *Definitions,* that for Asset Adequacy analysis removes the specific mention of various forms it may take. Thus, this is more general. In the *Opinion,* the reliance language has been modified to state that the actuary has reconciled the underlying basic asset and liability records to annual statement. At the discretion of the commissioner, language in the opinion referring to the adequacy of reserves in light of the assets may be omitted for single-state companies. Thus, a commissioner can exempt domestics which do not sell in other states.

What Happened at Nashville:

Just before the Spring meeting in Nashville, there was some correspondence after the December meeting, and two changes were incorporated into the final draft. In the marked-up version, Section F (1) was changed to read:

"As an alternative to the requirement of 6B(b)(c), the Commissioner may make one or more of the following additional approaches available to the opinion actuary." Section F deals with the Alternate Option. This deals with alternates to the standard language of the opinion which states that the opinion meets the requirements of the state of domicile and are at least as great as the minimum aggregate amounts required by the state of filing. The prior language stated that the commissioner may adopt one of the list of alternates.

The change above, suggested by the ACLI, allows more options. The second change was also to Section F(1). This also deals with alternate language. The previous version required the Company to file a request by March 31. The change allows a later filing.

How This Revised AORMR Affects Whom:

Note that every company (and fraternal society) must provide a memorandum annually. But what tests are required in the memorandum are left to professional discretion (subject to the actuarial standards of practice). This may save work. Let us say that a company uses cash flow testing for all or some of its business. Over a year, if conditions remain the same, it might be up to professional discretion to demonstrate that conditions are the same and refer to the previous year's study. This would probably save time and money overall.

Another problem is that the commissioner can impose his own requirements on the appointed actuary. One might tacitly assume that such requirements will be developed in a reasonable manner and will deal with innovative assets and liabilities. The open-ended language will allow the regulators to keep abreast of changing conditions. But it also allows the regulator to impose detailed conditions on smaller companies selling traditional products with traditional assets. Some fear this discretion.

If the proposal passes, every company will have to do some sort of analysis at least once. This would probably take the form of a gross premium valuation. Remember that ASOPs would be developed requiring this. ASOPs are not subject to state approval. Thus, the Academy will be able to set the details, and the states (with input from the companies) will have not ability to limit this. This lack of limitation is what some fear.

In the course of the development, in order to placate the concerns of the smaller companies, the one-state exemption was included. This means that a company operating in a single state might obtain the consent of the commissioner to omit the memorandum. There are many one-state companies. This includes some fraternals as well as some companies in the burial business. But it also includes some substantial farm bureau companies and large fraternals in single states.

Should single-state operations be the criterion for exemption? There are some companies in only a handful of states who would not be exempt.

This is expected to pass in June. Then it goes to each state to adopt (or not).

A copy of the most recent version can be obtained from the NAIC or the Society's Web site under the Smaller Insurance Company Section.