



SOCIETY OF ACTUARIES

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reserves on the reinsured contracts will unduly restrict the ability to invest prudently. A ceding company may be forced to manage asset pools so small they would be unable to accomplish A/L matching techniques or proper diversification.

Certain regulators have been quite strong in voicing opposition to the industry position. The reinsurance subgroup is willing to compromise somewhat by allowing asset mixing in certain limited situations. The subgroup noted several areas where mixing of assets is felt not to be proper—such as mixing assets covering both flexible premium and single premium annuities.

Since consensus on this issue has not been reached among industry and regulators, the subgroup recommended that language further clarifying this issue not be included in A-791, which some feel will be interpreted to disallow any mixing of assets.

Modco with Funds Withheld

THIS ISSUE IS whether or not funds withheld by the reinsurer violate

provisions in A-791 that require payments of amounts owed by the reinsurer to be made within 90 days of the settlement date. The industry position is that modco treaties with funds withheld are really identical to co/modco treaties, the only difference being the recording of the reinsurance credit as a receivable asset in the case of co/fw and as a reserve credit in the case of co/modco.

The reinsurance subgroup believes that the original intent of the drafters of the reinsurance model regulation was to disallow reinsurance accounting for modco/fw treaties, and has therefore taken the position that the proposed industry wording making exception of the 90-day requirement for modco/fw treaties not be accepted.

Richard H. Brown, FSA, is consulting actuary at KPMG LLP in Chicago.

Actuarial Guideline XXXIV

by Cherri R. Divin

Variable annuities generally provide a minimum guaranteed death benefit (MGDB) in the event of an untimely death that occurs when the fund values of the variable annuity have dropped. Examples of MGDB's are a return of premium at interest or the highest fund value on any previous anniversary. Actuarial Guideline XXXIV (AG 34) provides a clarification of the commissioners annuity reserve valuation method (CARVM) for variable annuities with MGDB's and specifically defines a reserve for the risk associated with any potential excess, if any, of the MGDB over the fund value of the annuity. AG 34 is effective as of December 31, 1998.

Although AG 34 addresses the additional risk related to a minimum guaranteed death benefit, it does not, however, specifically address the risk associated

with a minimum guaranteed "living" benefit, such as a guaranteed minimum income benefit (GMIB) or a guaranteed minimum annuity benefit (GMAB). The GMIB can provide a guaranteed minimum income benefit that is derived from the guaranteed annuitization rate and the value of an accumulation of premiums at guaranteed interest rate. Alternatively, the GMAB might provide a guaranteed floor value (e.g., 90% of premiums) that is available upon surrender. Working in conjunction with the NAIC, a work group of the American Academy of Actuaries is looking at reserving methods for the types of risk exposure related to these benefits.

The AG 34 minimum reserve is the greatest present value in any one calculation period of the following three integrated benefit streams:

1. Unreduced benefit streams paid on

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From the Editor

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game. As this year rolls on, we will be watching the product trends to see if this atmosphere for the future can be predicted.

The Life Disclosure Working Group is evaluating the impact of the Illustration Actuary Model Regulation. As mentioned in the the article, they are seeking input on any perceived problems. So those of you who want to, can have an impact.

The Unified Valuation System (UVS), a sweeping proposed revision of the Standard Valuation Law, is discussed on page 10. This is making progress. I attend some meetings and keep up-to-date. Although not an immediate priority, it will produce significant change if and when it is passed.

Many small companies perceive the current AOMR as troublesome and expensive, but there are attempts being made to revise it some more. Norm Hill is keeping us abreast of that. Cherri Divin discusses Guideline 34, which affects annuity valuation.



In order for there to be a *small talk*, there must be small companies. Based on big moves in mergers and acquisitions during the past year, this sometimes appears in doubt. We have a condensation of an article by Jacqueline Bitowt on the darker side of these activities.

All in all, this issue covers many different subjects because there are lots out there. We are trying to emphasize the ways each affects the smaller companies.

James R. Thompson, FSA, is a consultant with Central Actuarial Associates in Crystal Lake, Illinois, Editor of small talk, and a member of the Smaller Insurance Company Section Council.

inherent in stochastic processing.

Originally, the requirement for sensitivity testing and confidence levels from such testing was based on the volatility of underlying experience data. Lately however, there may be a tendency to rely on elaborate statistical mainframe programs involving some type of modeling. Input data, instead of being based on experience, is based on arbitrary assumptions that may have no tie to reality, but correspond to some type of curve known and desired in advance.

Therefore, the basic questions stemming from work of the Valuation Task Force are:

1. Are formula-prescribed actuarial reserves hopelessly out-dated, or still appropriate for many types of business? In this context, "formula prescribed" extends to fund accumulation reserves.
2. Is some type of stochastic processing the wave of the future in computing actuarial reserves? Is its only limitation to be available computer power and speed? Alternatively, is stochastic processing a flawed theory whose time should never come?
3. Is the insurance regulatory process willing to accept reserves based on actuarial judgment, with assumptions that vary each year?
4. So far, the official ACLI position has been support of statutory accounting, including its framework of prescribed formula reserves. Can this position be changed to support radically new reserve approaches?

Conclusion

CONTROVERSY OVER THE actuarial reserve opinion and the Standard Valuation Law itself will undoubtedly continue for some time. The critical importance of these issues for small companies and the entire actuarial profession cannot be overstated.

Norman E. Hill, FSA, is Senior Vice President and Chief Actuary of Kanawha Insurance Company in Lancaster, SC. and a member of the Smaller Insurance Company Section Council.

Actuarial Guideline XXXIV

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- death; e.g., expected death benefits
2. Base benefit streams paid to survivors, e.g., expected surrender values paid to survivors
3. Projected net amounts at risk paid on death; e.g., MGDB's

The first two benefit streams include the elective and non-elective benefit streams described by Actuarial Guideline XXXI-II, "Determining CARVM Reserves for Annuity Contracts with Elective Benefits." The third benefit stream covers the projected net amounts at risk for the MGDB upon death. The first two benefit streams are based on projections using a return equal to the valuation rate less appropriate asset based charges.

The projected net amounts at risk for the third benefit stream are based on a projection using an immediate drop followed by an accumulation at the net assumed returns for each asset class, as follows below:

<i>Asset Class</i>	<i>Immediate Drop</i>	<i>Gross Assumed Return</i>
Equity	14.0%	14.0%
Bond	6.5%	9.5%
Balanced	9.0%	11.5%
Money Market	2.5%	6.5%
Specialty	9.0%	9.5%
<i>Fixed Account</i>	0.0%	<i>Guaranteed Rate (Net Rate)</i>

Prior to AG 34, one method of determining the net amounts at risk was to assume a one-third drop followed by an accumulation at the valuation rate. This method is similar to the existing method used in New York. As you can see, a projection based on the above AG 34 rates would generally produce a smaller net amount at risk than the one-third drop method. Thus, the AG 34 minimum reserve would be expected to be less than the minimum reserve produced by this alternative one-third drop method that is used by some states.

The reinsurance reserve credit is defined as the excess of the CARVM reserve using the integrated benefit

streams without reinsurance over the CARVM reserve using the same streams but adjusted for reinsurance ceded. This method can lead to an unexpected result. For example, the projection of reinsurance cash flows for some variable annuities can cause the reserve net of reinsurance to exceed the reserve before consideration of reinsurance ceded. In such case, the reinsurance reserve credit would be negative.

The 1994 Variable Annuity MGDB Mortality Table is to be used in the reserve projections. This table is equal to the 1994 Group Annuity Mortality Basic Table, increased by 10% for margins and contingencies, without projection.

It would not be uncommon for a company to hold a reserve equal to the account value in the separate account and not apply CARVM calculations. In the event the company can demonstrate that their total reserve meets or exceeds the

total reserve specified by AG 34, no additional MGDB reserve would be required. On the other hand, a company that holds the surrender value in the separate account might need to hold an additional MGDB reserve in the general account. As you can see, AG 34 sets forth a minimum reserve standard in total, but the company may determine the appropriate allocation between the general and separate accounts.

Cherri R. Divin, FSA, is Senior Manager at KPMG LLP in Chicago.