



SOCIETY OF ACTUARIES

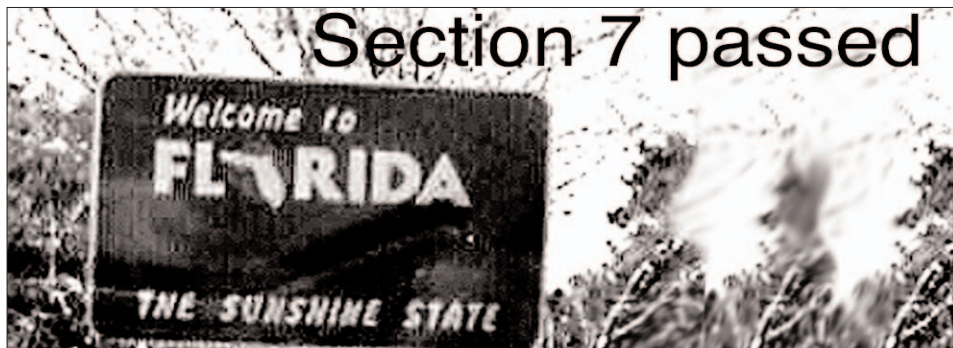
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Section 7 Update

by Mark C. Rowley



Last November, I wrote an article for *Small Talk* describing why Section 7 opinions were on their way out. The reason given was that the new Actuarial Opinion and Memorandum (AOMR) regulation had been passed by the National Association of Insurance Commissioners (NAIC) and that it was expected to pass in many states in 2003 and 2004. As it turns out this was a poor forecast since as I write this only the Florida Department of Financial Services has passed the regulation. Much of this is due to the AOMR receiving low priority by busy state insurance departments. However, some of it is also due to state insurance departments (and the industry) being dissatisfied by the alternate actuarial opinions proposed. Note that Florida's version excluded the alternate opinions. These alternate opinions were designed to assist appointed actuaries in dealing with state variations in valuation laws.

At first glance, it might appear that the only thing to report along the lines of Section 7 is that nothing much has happened. Only one state has passed the regulation, which can't possibly have much of an impact, right? On the contrary, what it means is that every company licensed to do business in the state of Florida must do a Section 8 opinion for year-end 2003 and annually, thereafter. Florida passed the law effective for all valuation dates after Jan. 23, 2003. Kerry Krantz, Valuation Actuary for Florida, confirmed my understanding of this in a recent e-mail. Also, Kerry recently made the following information available on the SOA general interest web board, for anyone interested in reading Florida's regulation.

Florida Administrative Code rule 4-138, part III, is avail-

able on the internet at <http://fac.dos.state.fl.us/>. Click Chapter 4—DEPARTMENT OF INSURANCE <http://fac.dos.state.fl.us/faconline/chapter04.pdf>. Then click D4-138.040 to get to the beginning of PART III ACTUARIAL OPINION AND MEMORANDUM.

According to Kerry, the "Scope" section of the regulation (4-138.041), paragraphs one and two, makes it clear that the regulation is effective for 12/31/03 valuations.

For all practical purposes, it appears that Section 7 opinions have gone for companies licensed in Florida. While a Section 7 opinion could be filed in other states, it probably makes sense to file a Section 8 opinion everywhere, as long as the work is being done. There are RBC (C-3 factors) and potentially rating agency advantages to filing a Section 8. Of course it also means that companies need to determine quickly what resources are available to do the asset adequacy analysis (usually cash flow testing) required as part of Section 8 opinions. It is also important to keep in mind that efforts prior to year-end reduce the effort needed in January and February.

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So are non-Florida small companies off the hook? Perhaps they are, for now. But there are other ways regulators can require Section 8 opinions other than the new AOMR. For several years, companies using X-factors as part of their compliance with XXX have been required to do a Section 8. Also, if you read the fine print of the 2001 CSO regulation, you will find that Section 8 opinions (asset adequacy analysis) are required for any company that values any of their business using the new mortality table. This will impact many companies for year-end 2004. For some companies, asset adequacy analysis will be so expensive it may be worth doing all the things necessary (no business in Florida, no X-factors, and no 2001 CSO) to avoid it. This may work for a small number of companies. 2001 CSO is just a minimum valuation standard, so if 1980 CSO produces higher reserves, it can still be used. However, this will be difficult, since products will become uncompetitive. In the long run, since the 2001 CSO will become the tax table, these products would need 1980 CSO reserves & cash values and 2001 CSO tax reserves and guideline premiums.

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