Article from:

Small Talk Newsletter

November 2000 – Issue No. 21

2001 CSO and The Small Company — More Effort Than You Might Think

by Mike Taht

R590-223-2. Purpose. The purpose of this rule is to recognize, permit and prescribe the use of the 2001 Commissioners Standard Ordinary (CSO) Mortality Table in accordance with Sections 31A-17-504, 31A-22-408 and R590-198-5.

The 2001 CSO mortality table was adopted by the National Association of Insurance Commissioners (NAIC) in December 2002. As of August 2003, three states (Texas, Oklahoma and Utah) had adopted the table, and a number of other states plan on adopting by January 1, 2004. 2001 CSO will have a significant impact on life insurance, affecting not only statutory reserves and non-forfeiture values, but also tax reserves, Section 7702 guideline premiums and universal life cost of insurance rates. However, there is one element of the table that may have a greater impact on small companies than large companies. This article touches on this specific issue.

One of the requirements that must be met to utilize the 2001 CSO table is that an asset adequacy opinion must be filed. This requirement was put into the regulation introducing the table to address certain concerns that regulators have regarding use of the 2001 CSO mortality table for statutory reserves. Specifically, regulators were concerned that the table was based on fully underwritten standard ordinary individual life insurance experience only, but that it could be utilized to set statutory reserves for business that was issued utilizing underwriting that was more lenient than full underwriting. The two examples raised, most often by regulators, were simplified issue and guaranteed issue life insurance products. Many small life insurers have significant portfolios of simplified issue or guaranteed issue life insurance (e.g., pre-need life insurance or funeral products).

Often, small life insurers in these markets have not been required to conduct asset adequacy analysis given their size. Even with AOMR (see Mark Rowley's article on "Impact of AOMR"), some of these companies may not be required to conduct asset adequacy analysis. The requirement to conduct asset adequacy analysis raises two primary concerns for small life insurers:

- What kind of model is the organization going to need to conduct asset adequacy analysis?

- Will moderately adverse mortality assumptions (used in asset adequacy analysis) be significantly worse than 2001 CSO and lead to additional reserves that are not tax deductible?

To date, there is not a clear answer to these issues. ASOP No. 22 references a number of different types of analyses that can be utilized to satisfy asset adequacy analysis. The choice of analysis must be appropriate to support the asset adequacy opinion. With respect to mortality being greater than 2001 CSO for some lines of business, this is not a new issue. In today's environment, there are some lines of business with expected mortality even greater than 1980 CSO. Two regulatory solutions that have been suggested during discussions of this issue are the creation of a simplified issue mortality table, and treating the simplified issue/guaranteed issue business as substandard. These solutions face challenges and little work has been done to date to make these suggestions a feasible solution to the issue.

For companies in this position, there are currently two primary methods to address the issue today:

- Do nothing: Although 2001 CSO has been adopted in a few states, a company does not have to utilize 2001 CSO for statutory purposes until 2009. In the interim, perhaps a feasible solution will be put forth by the industry.

- Develop asset adequacy models: Develop reasonable asset adequacy models to see if moving to 2001 CSO results in additional reserves due to asset adequacy testing. It should be noted that persistency and realistic interest rates are also utilized in asset adequacy testing, and could some what off set the impact of higher than 2001 CSO mortality. Although additional reserves may be necessary, the benefit of a reduction in basic reserves due to 2001 CSO may outweigh the cost of additional asset adequacy reserves.

In the end, this is a key issue that small companies should consider when determining whether or not they should utilize 2001 CSO for statutory reserves.●

Mike Taht can be reached at tahtm@towers.com