



SOCIETY OF ACTUARIES

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## The Status of Proposed Revisions to the AOMR

by James R. Thompson

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 non-investment grade bonds to capital and surplus), smaller companies many have to perform this analysis and develop a memorandum.

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

### History of concerns

OVER THE YEARS, REGULATORS have been concerned with innovative products and newer asset types. Some companies could be participating in risky behavior and not have any analysis. The current regulation has

### History of the small Policies continued from page 4

while the small policy's progenitor is quickly disappearing, the small policy is still alive in the forms of ordinary life, final expense, and pre-need insurance, which do, and will for years to come, serve the needs of their policyholders.

As it was in 1875 before the Prudential introduced the small policy on a large scale in the United States, no criticism can diminish the value of small policies. The elderly and moderate/lower-income people need life insurance and are able to serve their needs with small policies. The history of small policies, which for a long time was the history of industrial insurance, has demonstrated that people of all means want life insurance, and people of lesser means need it most.

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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.

This year I witnessed the development of a new proposal which might succeed. At the March meeting of the Life and Health Actuarial Task Force (LHATF) and also at the meeting of the National Association of Insurance Commissioners (NAIC), the regulators all agreed they wanted to get rid of the smaller company exemptions and the mandatory seven interest scenarios for the cash flow testing but also rely more on professional judgment.

At the September (third quarter) meeting, they put an official proposal on the table for exposure. This proposal could work its way up the ladder for adoption by the LHATF, then the Life Committee of the NAIC, and finally the NAIC by March or June 2001.

This is a significant proposal. The regulators think it has been exposed enough, but I believe many smaller companies have not discussed this because of the usual time pressures. I witnessed various industry groups making comments, but I am not sure all of the smaller companies have been paying attention. Thus, I think we should begin looking at how this proposal will affect various companies. Will it be helpful? Expensive? Less expensive?

### Outline of changes

UNDER PURPOSE, THE PROPOSAL 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.

### How This Might Affect 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 the commissioner can impose his/her 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 the 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 being developed would require 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 no ability to limit this. This lack of limitation is what some fear.

In order to placate the concerns of the smaller companies, the one-state exemption was included. This means a company operating in a single state might obtain the consent of the commissioner to omit the memorandum. Many one-state companies exist. This includes some fraternal and some companies in the burial business as well. It also includes some substantial farm bureau companies and large fraternal 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.

The smaller insurance company Section members have learned over the years that their input is valuable. Prior to the December meeting, make your opinion known to Mark Peavy at the NAIC or to the management of your company.

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