SOCIETY OF ACTUARIES

Article from:

Small Talk

November 2010 – Issue No.35

Regulatory Update – 2010 NAIC Summer National Meeting

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Although no drastic changes occurred at the 2010 NAIC Summer National Meeting in Seattle, several areas are worth mentioning and discussing.

Principle-Based Reserves (PBR)

The Life and Health Actuarial Task Force (LHATF) resolved several remaining amendments to VM20, the section on reserve methodology. Most of the amendments had been unresolved due to New York's objections. Some amendments already in place have two alternatives, one with the more conservative approach desired by New York, and the second a less conservative method desired by the American Council of Life Insurers (ACLI) and American Academy of Actuaries (the Academy). Therefore, a "final" exposure draft of VM20 was issued.

So far, the Smaller Insurance Section Council desired approach to valuation for traditional products (Amendment 20 as proposed by Katie Campbell, or the "Campbell" approach) has held up. By passing one reasonable test that does not require undue work, PBR reserves revert to the current National Association of Insurance Commissioners (NAIC) statutory reserves.

The key next step is a full scope field test of the proposed approach to PBR, as agreed to by the ACLI and the LHATF's parent committee. For a wide variety of products, including simplified issue and guaranteed issue (SI/GI) products, gross premium reserves (in some cases, stochastic reserves) will be compared to current statutory reserves. The ACLI's net premium reserves will also be computed. Companies chosen from 60 large insurers, plus a few "small" companies and a few reinsurers, will be asked to perform these reserve tests, not necessarily on every one of their products. A consulting actuarial firm will be chosen by the NAIC to coordinate these tests. Apparently, companies will use their own assumptions for reserves, but broadly corresponding to VM20.

The field tests are still in flux. Therefore, it is not clear whether such unprescribed assumptions will hold up. The goal is completion of the study by year end 2010. The ACLI cautioned that this is not realistic, and completion may well continue into late 2011. This would mean that the new SVL and VM could not be submitted to any legislatures until 2012 or 2013.

With such instability, one risk is that our desired Campbell approach for traditional products could be withdrawn. While preneed is currently exempt from PBR, we can't even take this for granted.

Possibly, the preferences of the chosen consulting firm could affect how the study is conducted. Some firms are more oriented towards stochastic processing than others.

In fairness, LHATF has been living up to its agreement that only a package of SVL and completed VM would be submitted to state legislatures.

Experience Reporting Under the Valuation Manual (VM)

This is covered under VM50 and VM51. A "final" exposure draft of VM has been issued, containing forms, but not the theory, for companies to use in filling out experience data.

Small companies have a five-year deferral from reporting requirements. However, with "small" not defined, this is of questionable value. New York's own regulation on experience reporting has an exemption threshold of $10 million premium, a very small limit.

A letter from the North Dakota Commissioner, Adam Hamm, who chairs LHATF's parent (Principle-Based Reserving EX WG) is significant. This memo, still undated, was approved by his WG and LHATF in separate conference calls, and

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submitted to the NAIC's Executive Committee at the 2010 Summer NAIC Meeting. His memo spelled out that "Smaller companies that have less than credible data would not submit their data to the statistical agent, and would in turn use industry data to set their assumptions, and would submit summaries of their experience directly to the requesting regulator. This aspect was a compromise to address concerns of small companies." While "small" and "credible" are not defined further, this could give further support for a company claiming exemption. However, LHATF has not incorporated the above paragraph into VM50 of VM.

New York has proposed that a new VM section 52 is needed for SI/GI product types often sold by small companies. Their hint is that this section would have no deferrals for small companies and immediate requirements for full experience reporting of the above type of products. At the meeting, LHATF ignored a statement from the Academy that many large companies with credible data also write SI/GI.

New York has already sent out a data call for 2010 on experience reporting. I was surprised to hear that the call covers all New York-admitted companies (even accredited reinsurers). The industry will try to move the effective date ahead to 2011.

Life RBC-C3 Phase 3

The current approach for this item is a scope limited to Universal Life with Secondary Guarantees (UL2G) over five years (RBC for variable annuities is already covered as C3 Phase 2). However, New York has finally prepared a letter, outlining some changes they want, such as continuation of current formulas as a floor. Therefore, no discussion at all occurred on this topic.

Obamacare

I was told that several companies selling limited benefit products have plowed through all of the new Health Bill. They are satisfied that for limited benefit products such as cancer, short term disability, and others, the 80 percent and related high loss ratios of the bill do not apply.

Health PBR

The ACLI has stated that final life methodology under VM20 should "set the tone" for eventual health PBR (VM25). However, the latest discussion of long-term care calculations under PBR indicates complete reliance on stochastic processing for reserves. Resolution here probably won't occur until after VM is considered "complete" for submission. This stage would mean completion of VM20, VM50 and VM51 (but probably not VM52 for SI/GI), VM00 which defines PBR scope, including exemption of preneed, VM01 with definitions, and VM21 for variable annuities (formerly Guideline 43). In other words, VM25 for Health would remain unresolved.

Comments

I heard several offhand comments from attendees worth noting. While not conclusive, they may indicate a general industry attitude towards this entire project:

"What will happen if PBR dies?"
"PBR seems to have impossible roadblocks."
"It seems clear that New York will never agree to any half reasonable PBR."

Miscellaneous PBR Items

On Guideline 38, Section 8C, the interim solution for Universal Life with Secondary Guarantees, is due to expire this year-end. After some discussion, the sunset date was extended three years to 2013.

Guideline 38 only allows use of 1 percent lapse rates. New York has always seemed to oppose such lapse assumptions, even though in a different PBR context, they agreed with 1 percent, as developed from a Canadian study.

One change was made to the formula for the Stochastic Exclusion Test (SET). Due to concerns about reinsurance expense allowances, LHATF agreed to modify the SET denominator. Instead of the present value of benefits plus expenses (and commissions), now only the present value of benefits would be included. Since this change would increase the SET ratio, the 4 percent threshold was increased to 4.5 percent.

On reinsurance, one longstanding issue was resolved. New York has long wanted reserves to be computed for the net ceded amount, and separately for the credit on each treaty. After lengthy discussion, it was agreed that in some cases where collateral from the assuming company was involved, separate treaty reserve calculations might be in order. However, the requirement for separate credit calculations and the amendment in general (Amendment 41) were rejected.

Solvency Modernization Initiative Task Force (SMI)

After the 2010 Spring NAIC National meeting, I mentioned my concern with several directions of working groups under SMI. While I couldn't directly attend these Saturday meetings, I reviewed their agendas and handouts. They indicated:

1. Scrapping statutory accounting is becoming more explicit as an objective. No reason is offered other than "certain jurisdictions" want use of international GAAP for regulatory purposes. Even a regulator like Steve Johnson (PA), who defended statutory accounting, mistakenly referred to it as "US GAAP with certain modifications." That may have been true at one time, but statutory accounting has been completely codified for some time.

2. Ed Stephenson of Barnert Associates indicated that a complete exposure draft of IFRS, international GAAP, for insurance contracts including reserves, is now available. He didn't indicate whether its previous terrible flaws are still present.

3. Completely redoing all life RBC formula components to a type of "actuarial projection" basis. This was the approach proposed for C3 Phase 3, which by now is limited to UL2G. Methodology for such a task is elusive, to say the least. No justification or need for such a mammoth project has been offered.

I have to wonder if some commissioners are hoping to impress Congress, in the hope of influencing the 2011 debates on Optional Federal Charter. This seems to be the only explanation for such impractical dubious projects. ●

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