SOCIETY OF ACTUARIES

Article from:

Small Talk Newsletter

November 2005 – Issue No. 25

Actuarial Guideline 38 – Finally Arriving

by Daniel E. Winslow

First, I'd like to offer a comment about timing in a rapidly changing world. This article is written on Sept. 1, 2005 in the aftermath of Hurricane Katrina. The devastation to New Orleans caused the cancellation of the NAIC Fall meeting in New Orleans. AG 38 had been expected to be voted upon by the Plenary and Executive Committees. Perhaps it will be the subject of a regulatory conference call or it may be delayed while the consequences of Hurricane Katrina take first priority.

An Oct. 7 update is that the NAIC Executive and Plenary meeting will be Oct. 14 and Actuarial Guideline 38 is on the agenda. The May 9 draft of AG 38 is available for download at the NAIC Web site until it is officially adopted. Visit *http://www.naic.org/documents/committees_models0505_AG_38-6.pdf* for this information.

This draft was adopted by the Life and Health Actuarial Task Force (LHATF) at its meeting on June 10, 2005 and adopted by the Life Insurance and Annuities (A) Committee on July 13, 2005.

Actuarial Guideline 38 has been one of the most discussed reserving changes in the past year. First proposed in late summer of 2004, several industry groups and LHATF have worked to reach consensus on this issue. The current draft is a compromise, sometimes referred to as the "CEO compromise" since the CEOs of several leading life insurers negotiated the language. It has proved to be a catalyst for change and provoked much discussion about the weaknesses of the current life insurance reserving system. Perhaps the most important idea is that it is meant to be a temporary solution while principles-based reserving methods are drafted. Valuation mortality tables are also being examined with the SOA leading an industry-wide experience study. The 2001 CSO valuation mortality table is still fairly new but already is considered too conservative by many.

Given the July 1, 2005 implementation date and the "sunset date" of April 1, 2007, as well as the length of the product development, state filing and marketing implementation process, insurers will mostly be using the current products in their portfolio with this revised AG 38. If an insurer has not already undertaken an analysis of this draft of AG 38, this analysis should be swiftly done.

The reserving increases for certain categories of product are likely to be significant. Some products may need to be pulled off the market because the statutory reserving strain may be too large for an insurer to bear. Smaller to medium sized insurers may have more trouble accessing the capital markets for capital to fund this strain.

In the new Section 8B, significant is the "DRAFTING NOTE: The 7 percent premium load allowance approximates an average premium load level as evidenced by policies currently sold in the market. Rather than have the funding ratio vary according to the actual policy loads (which can fluctuate greatly by company and product), all companies will use an identical premium load allowance at a level approximately equal to the current industry average."

This is intended to bring whole life insurance type reserves to products with extended guarantees and close a perceived loophole in the prior AG 38 Section 8.

The following language serves as a point of interest. "However, the specified reserving approaches should be modified as needed to comply with the intent of this guideline that similar reserves be established for policy designs that contain similar guarantees." That sentence does not have the clarity of the previous formula-based reserving methods that have been fairly well settled in application and practice.

Well, life in life insurance product development and life insurance statutory reserving is likely to stay interesting for the next few years! Best wishes to all those company actuaries working to sell competitive products that serve policyholders and insurers well. ●

Daniel E. Winslow, FSA, MAAA, is president of Winslow Financial LLC in Lake Forest, Ill. He can be reached at dan.winslow@winslow-financial.com.