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smalltalk

Complying with the Actuarial Opinion and Memorandum Regulation in 2010: Which Interest Rate Scenarios are "Moderately Adverse"?

By Robert W. Guth, Mark C. Rowley and Donald M. Walker

Analysis by a Reasonable Actuary

The Actuarial Opinion and Memorandum Regulation states that the purpose of asset adequacy analysis is to certify that assets are adequate to cover reserves under "moderately adverse conditions." A significant part of this determination is to do testing using interest rate scenarios that are "moderately adverse." ASOP No. 22, section 2.15 defines moderately adverse conditions as: "Conditions that include one or more unfavorable, but not extreme, events that have a reasonable probability of occurring during the testing period."

So it is clear that there are certain scenarios that are "extreme," and that assets are not required to adequately cover reserves under these conditions. It can be argued that in 2010 the level interest rate scenario, and even more so the three down scenarios in the New York Seven are "extreme" scenarios that do not have a reasonable probability of occurring during the testing period.

It may be true that the level scenario has been a "moderately adverse" scenario ever since the New York Seven scenarios were first developed, and that 2010 was the first time it was an "extreme" scenario. The determination of whether a scenario is "moderately adverse" or "extreme" should be based on a "first principles" evaluation of whether the scenario has a "reasonable probability of occurring during the testing period." In 2010 the probability of rates staying at their historically low levels for the entire testing period is very low indeed. In making this determination, it is relevant to look at the opinions of economists. One question to ask would relate to the probability of a Japan type event for interest rates occurring in the United States.

Economics 101 (The Taylor Rule) tells us that interest rates are made up of two primary components: inflation and growth. What happened in 2010 was that there was basically no inflation and no growth. For the level interest scenario to have a reasonable probability of occurring, one has to be willing to believe that there is a reasonable probability of no inflation and no growth for decades. The chance of this occurring would appear to be miniscule.

It is outside the scope of this article to contrast in detail the situations in Japan and the United States, but we can list a few of the factors typically pointed out by economists:

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From the Editor

It's Your Interests that Drive Us!

By Michael L. Kaster

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This edition of *smalltalk* is my first as editor. *Smalltalk* is published twice a year, for the benefit of the section members—those actuaries who work for and/or support the smaller insurance company. "Small" is a relative word. One company might consider itself small because it only has 200 employees. But it could easily have several billions in assets, which another actuary may consider too large to be considered small. However, I would argue that it doesn't really matter. If you are a member, and you feel you would benefit from the considerations of others who consider themselves to be in your company as a small company actuary, then why not listen to what they have to say?

That is what you will find in this edition of *smalltalk* … several articles discussing the perspective of other actuaries who feel they are in the same position as many of you … working for or supporting the smaller insurance company.

- Asset Adequacy in 2010 — What is meant by "low" interest? Section Council members Robert Guth and Donald Walker, along with Friend of The Council Mark Rowley, discuss their thoughts and perspectives on 2010's low-interest-rate environment and what some of their considerations have been in dealing with the need for "moderately adverse" scenarios in light of historical low interest rates.
- Chairperson's Corner—our Section Council chair, Sharon Giffen, gives us her perspective on the current events around the globe, and how we should all consider enterprise risk management (ERM) improvements.
- ASOP No. 41 Update—Recently updated, this ASOP on actuarial communications is summarized in an article written by Sharon Giffen.
- Regulatory Update—Norm Hill shares some updates and perspectives from the recent NAIC meeting, as well as an update on principle-based reserves (PBR).

I wanted to also bring to your attention some of the important activities of the Smaller Insurance Company Section Council. This council operates on the behalf of the members, and does so with very little budget for resources. However, they don't let a limited budget stop them from producing some extremely valuable events for your benefit.

Webinars

- On March 8, there was a webinar on "Professionalism for Actuaries in Smaller Insurance Companies—ASOP No. 4," which received many compliments and was very well attended.

- The "Gathering and Managing Experience Data" webinar is scheduled for June 9.
- Future webinar topics being considered include an "Appointed Actuary Boot Camp" and "Year-End Financial Reporting."
- The section plans to offer quarterly webinars. If you have any suggestions, please contact a Section Council member. You can find them at *http://www.soa.org/professional-interests/smaller-insurance-company/sic-smaller-insurance-company-section-detail.aspx*.

Meetings

- "Small Co" also sponsors sessions at most all the major meetings sponsored by the SOA. At last month's Life & Annuity Symposium, we sponsored two sessions. The first was on "Tax Reserves for the Non-Tax Actuary," co-sponsored with the Taxation Section. The other session was "Hot Topics for the Smaller Company," a buzz group format, which allowed actuaries from small companies to gather and discuss current issues.
- For the eighth consecutive year, we are sponsoring the Smaller Insurance Company Chief Actuaries Forum on September 13. This event is part of the Valuation Actuary Symposium.
- And, of course, let's not forget the ever-popular buzz group discussions at the SOA Annual Meeting in October.
- Again, if you have suggestions for topics you would like to see covered, please contact a Section Council member.

I am honored to be serving as editor of *smalltalk* and welcome your comments, article ideas and feedback in general. Great things happen when we work together for our benefit.

Chairperson's Corner

Disaster Recovery Plan—Do You Have One?

By Sharon Giffen

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As I write this, I have just returned from the Enterprise Risk Management Symposium, where, between the sessions, we were following the events unfolding in Japan—the massive earthquake and tsunami and threatened nuclear meltdown. Frighteningly, this was close on the heels of a devastating earthquake in Christchurch. Floods in Australia started in 2010, but worsened in 2011; Rio de Janeiro has been suffering under floods and mudslides. Less than three months of 2011 have elapsed.

And this is not the beginning. Thinking about the major news of 2010, we can recall watching in horror as oil poured for weeks from a ruptured wellhead into the Gulf of Mexico, and in amazement at the ash pouring for weeks from a volcano in Iceland. We saw the poor of Haiti lose their meager belongings in yet another earthquake and the suffering in Pakistan and Indonesia amid their floods. In contrast, we also witnessed the euphoric 33 Chilean miners, rescued 69 days after being trapped 2,300 feet underground. We still wonder about the cause of the huge number of mass animal deaths all over the world in the second half of 2010.

I haven't even mentioned yet the political and economic disruptions rising in Libya, Egypt, Bahrain and Greece, and WikiLeaks; any of these could be the event that precipitates a new economic crisis here. Closer to home, health care reform, the Dodd-Frank Act and International Financial Reporting Standards are all changing how we do business.

You are probably wondering, what has all of this to do with our lives as actuaries in smaller insurance companies? I see three lessons for us.

First, our economy is global. Over the past few years, we have seen just how much our economies are interrelated. No country stands alone, and we see economic impacts from such varied events as the rebellion in Libya (price of oil), Chinese inflation (trade imbalance) and the tsunami (stock market jitters). How do we arrange our investments to best weather whatever storm comes along? Each of us has needed to evaluate asset allocation in light of our liabilities to ensure they are managed in sync. Are you appropriately diversified—by sector, by geography, by term and by quality? Have you considered risks of various economic scenarios such as deflation, inflation, recession and normal growth? Diversification and a sound long-term policy that considers various scenarios may not be sufficient to avoid losses in a crisis, but we can mitigate losses to assist in securing the future of our companies.

Second, we should all have good business disruption and disaster recovery plans. Not all disasters are of these epic proportions, but if something hits your business, it can be all-consuming. The simplest and most important element of your plan should be to exchange personal contact information in several forms among relevant staff. A key to early success is just being able to communicate live. Plans should exist for disruptions of many natures, since it will be unknown in advance who will be available to work and what facilities will be operational. Questions to consider: will your data be available, and will ongoing backups be made? Will you be able to process new business? Will you be able to pay your sales force? Are you depending upon the Internet to continue your business? What happens if the disaster is that someone has sabotaged access to the Internet? Does that change your business resumption plan?

Third, let us not lose sight of our core business of taking insurance risk. Whether life, health or property/casualty, do you have an appropriate diversification of risk—by risk, by geography, and by channel? Do you have good catastrophe arrangements in place for the "unthinkable" event? Have you done your due diligence on your reinsurer to be comfortable that they will be there when you need them?

There are many other aspects to risk management that I have not covered. The subject fills many texts and I have not done the subject justice. I encourage each of you to consider what you can do in your company. It does not take sophisticated models, or teams of "quants" to start the process and put in place the early foundation of a risk management program.

In closing, I can only hope fervently that by the time you are reading this, the situation in Japan is under control and the rebuilding will have begun.

- The savings rate in Japan is a lot higher, even given the recent uptick in savings in the United States. The United States is a country that spends, and this is expected to spur growth.
- The demographic advantages in the United States are significant. We are a lot younger and our growth rate is a lot higher. We have a lot more earners versus those living on savings. This should spur growth.
- The aggressiveness and responsiveness of the Federal Reserve, and the better starting position of U.S. financial institutions. Japan's banks were in poor shape due to real estate assets, and the government didn't require them to be held at impaired values.

At the end of 2010, the Treasury curve ranged from a 90-day rate of 0.12 percent to a five-year rate of 2.01 percent and a 30-year rate of 4.34 percent. A short rate of 0.12 percent is as low or lower than rates of the Great Depression. Projecting those rates in level or down scenarios for 40 years would be like extending the Great Depression from 1930 to 1970.

The steepness of the yield curve of the level scenario is not consistent with projecting that scenario for 40 years. Such a steep yield curve implies a market belief that rates will rise. Such a yield curve invites arbitrage, and suggests that market traders are still concerned about credit risk. If market traders believed that rates were to stay low, level and stable for 40 years, the yield curve would become much more flat as it did in the Great Depression.

> "Projecting those rates in level or down scenarios for 40 years would be like extending the Great Depression from 1930 to 1970."

The Need for a New Baseline

A logical conclusion from all this economic analysis is that a new baseline is needed, and a new measure of moderately adverse scenarios should be developed. Appointed actuaries in 2010 in the United States have developed baseline scenarios in various ways:

1) Level for three years, and then rises while flattening over the next five years.
2) Start with today's yield curve, and then grade this to a "normal" yield curve over three years.
3) Use the forward rates that can be derived from today's yield curve.

These are all interest rate scenarios that assets should be adequate to cover. Variations on these scenarios could also be developed to be "moderately adverse" scenarios:

1) Level for five years, and then rises while flattening over the next five years.
2) Start with today's yield curve, and then grade this to a "normal" yield curve over five years.

Perhaps the following scenarios would be considered "extreme":

1) Level for 10 years, and then rises while flattening over the next five years.
2) Start with today's yield curve, and then grade this to a "normal" yield curve over 10 years.

A reasonable conclusion from the above analysis is that in 2010 the level scenario was "extreme," meaning that companies shouldn't be required to have assets that cover reserves under these conditions.

Counterpoint and Practical Considerations

While it is true that a reasonable actuary could conclude that the level scenario is too "extreme" to use in forming an Asset Adequacy Opinion, that same actuary should still be aware of professional and practical considerations that could argue for its continued inclusion in the analysis.

First, many actuaries will argue that professional responsibility would require the inclusion of the level scenario as a sensitivity test, with discussion of the results in the memorandum, even if the result was not given full weight in setting up additional reserves. This would provide a baseline for comparison with past and future years.

An obvious practical consideration is whether the actuary is expressing an opinion to a regulator in New York or another state that requires the New York scenarios. The New York Seven are part of New York's requirements, and there is no reason to believe that New York is willing to change its rules. (In fact, a brief review of the latest version of The New York department's so-called "Halloween Letter" would indicate that New York isn't considering any change.)

Absent New York, consideration should still be given to the attitude of the company's state-of-domicile regulator. It would seem prudent to pose this question. In particular a question to ask is whether all seven scenarios need to be passed, or whether all seven scenarios only need to be considered.

A further consideration would be the attitude of the company's auditor. (And, while some of us consider these as pragmatic steps, others may take the position that such consultations are professionalism requirements.)

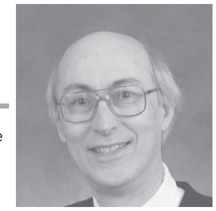
Regulatory Risk at the Heart of the Matter

The overall issue becomes one of regulatory risk. If the actuary decides unilaterally to exclude the level scenario from consideration, there is the possibility that someone else may take issue with that decision and be able (through regulatory authority) to make that stick. This could cause an unexpected change to reserves that has the potential to be awkward for the company and the appointed actuary.

The one constant on the interest rate front for the last three year-ends has been, "How long will the Fed keep rates ultra-low?" How many of us would have expected the answer to be this long? (But let's not forget what has gone on in Japan over the last two decades!)

The concern is that, if the actuary decides to exclude the level scenario and therefore avoids putting up additional reserves over several years, a regulator could ultimately decide that the company needs to put up all of the missing reserves at once. If the company has been making business decisions based on reserves that turn out to be inadequate, the result could be bad.

Of course this matters the most if your company would have to hold extra reserves to have adequate assets when running the level scenario. We hope that you are fortunate enough to not have to hold extra reserves when running the level scenario!



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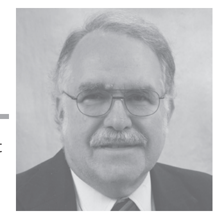

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Update on Actuarial Standard of Practice (ASOP) No. 41—Actuarial Communications

By Sharon Giffen

The Actuarial Standards Board (ASB) approved a new version of ASOP No. 41 in December 2010, to be effective on May 1, 2011. This new standard is intended to clarify requirements for the form and content of actuarial communications, including the contents of documentation and disclosures for the users of actuarial opinions and findings. In this article, there is a summary of the new standard, with commentary on changes compared to the previous version. Following this are comments on the implications that may be relevant to actuaries working in smaller companies, with some examples that may provide a sense of what would appear to be appropriate in some specific circumstances. Finally, in closing, there are some questions that remain, which will be left for you to ponder.

Overview of the Standard

ASOP No. 41 defines what an actuary should communicate, when that communication should happen, and what should be disclosed. At the heart of the standard are the definitions [Section 2] of what constitutes an actuarial communication (includes oral communications), an actuarial document (any form that is recorded, including electronically) and an actuarial report (a set of actuarial documents that are relevant to the topic at hand, and are available to the user of the findings).

Section 3.1 specifies general standards for actuarial communication. Sections 3.2 and 3.3 provide standards regarding when an actuarial report should be provided and what it should contain. The specific disclosures for an actuarial report are gathered in section 3.4. Interestingly, in section 3.6, there is specific guidance around oral communications, including the requirement to follow up with a document, if there is a concern that the communication may be passed on the other parties.

Section 4 provides guidance for the disclosures to be included in an actuarial communication, including some additional guidance for the contents of an actuarial report [section 4.1.3]. Included as well is some guidance on dealing with situations where the actuarial finding depends upon either someone else, or a prescribed method or assumption. Finally, it also helps us to understand how to handle what would otherwise be a deviation from the guidance in an ASOP.

What's New?

Four new key elements were introduced. First, and importantly, the concept that actuarial communications can be ongoing and interactive was introduced; an actuarial report may be a collection of documents and other communications—which may take place over time and in various forms. This report clarifies what is to be considered an actuarial communication.

Second, it clarifies that, in some situations, full disclosure of assumptions and other supporting information may not be necessary; of course, the actuary should be prepared to defend the decision to omit information.

Third, it gives more specific guidance on the treatment of assumptions. If certain assumptions are provided or prescribed, the actuary must disclose the extent to which the assumptions were validated by the actuary. If no disclosure is provided, it is then assumed that the actuary endorses that particular assumption.

Additionally, there is clarification and alignment of wording, particularly with respect to deviation from the guidance of an SOP. Section 4.4 on deviations from standards applies to all ASOPs. An actuary can comply with an ASOP—without following all of the guidance in the ASOP—by documenting any material deviation, justifying it, and estimating its impact.

Implications for Smaller Companies

Certainly ASOP No. 41 does not provide any differentiation or relief for those actuaries who work in smaller insurance companies. However, the circumstances under which the actuary works may be different, which means we may invoke section 3.3—which allows for documentation to be incomplete, as long as it is appropriate for the user and in the circumstance—more frequently, for our ongoing informal communications.

There are two main areas where the experience of an actuary in a small company is likely to be different from large or even medium-sized firms. First, there are generally significantly fewer human resources to help share the workload. Often there is no actuarial staff or only a one- or two-member actuarial staff. These small staffs may include actuarial students, so there may be very limited assistance in assembling documentation and reports. Second, there is typically a greater propensity to rely on the work of consultants. To what extent, then, does that reliance allow us to form an opinion without documentation?

Staff Size Matters!

In many smaller companies, there is only a very small actuarial staff, sometimes only one actuary. In such a case, there is always a great deal to try to get done; there is always another project waiting as soon as one is complete. That leaves little time for documentation and the assembly of a formal actuarial report, especially for those tasks where the work is not subject to the requirement to be available to auditors. It is important to develop practices to pull the documentation together as you go, and not leave it to the end of the project. Since many of your communications will be read by non-actuaries, it could be that the best peer-reviewer regarding content and clarity might be a non-actuary or student actuary in your firm.

"It is important, too, to record those hallway conversations that led to a decision."

ASOP No. 41 clearly allows for the idea that a report can consist of a collection of documents, including spreadsheets, presentations and notes. In many ways, this makes it significantly easier to pull things together. Electronic files are acceptable, and you can therefore simply create a folder, either within your email system or on a shared server. Then, as you complete a piece of documentation, add it to the folder, and it is now part of your report. Be cautious, however, of having multiple versions in your final folder—you want it to be clear what you finally decided. This allows for the scanning and saving of handwritten notes as well as more formal documentation. The final actuarial report should be coherent; it should be complete, except for documented and justified omissions; and it should allow another actuary familiar with the area of practice to evaluate the reasonableness of the work.

It is important, too, to record those hallway conversations that led to a decision. In the interest of clarity, it is good practice to follow those up with a quick email, just to note the decision and rationale. This is also sound business practice. Who knows when you'll be asked to recall a certain conversation. There are simple techniques that help to guard ourselves from misinterpretation and misunderstanding.

Good documentation requires that your report folder is as complete as is practical and as would be useful to the user. Of course, if you have a more formal process that includes project management disciplines, those notes are a good record of the process as well.

Use of Consultants

Small companies often use consultants extensively, for regular actuarial work or for project-based work. In some cases, the consultant is treated by internal staff as an extension of staff. One would then need to consider how to incorporate the consultant's work into the internal documentation.

Where there is a formal report from the consultant, can the internal actuary simply identify that report as the only documentation for the opinion? Actual facts and circumstances may dictate different answers for different occasions.

Imagine a situation where an external consultant has been retained to develop a new product. The company actuary provides underlying mortality assumptions (based on studies done for valuation) and expense information for administrative and distribution compensation. He asks the consultant to develop other assumptions and do a profitability analysis. In this case, the external actuary is going to document that certain assumptions were provided by the client and will express reliance on those assumptions. The internal actuary would then need to document the missing pieces, but express reliance on the work of the consultant. This would assemble the total requirements of the actuarial report, without having to duplicate work.

In another example, a consultant is called for a quick "off -the-cuff" discussion about the potential appraisal value of an insurance company. This can be a difficult situation to navigate. Are there rules of thumb that are so common as to be not "actuarial findings" that are based on actuarial work? Not likely. So, even in such a situation, the actuary will need to be

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very conscientious about when they have moved into providing "actuarial" advice.

Where Does That Leave Us?

I would like to leave you with two questions that I think are worthy of pondering.

Clarity Versus Detail

First, actuaries have sometimes been accused of not being able to provide a simple, straightforward answer to any question. As a profession, we have the reputation of being ineffective communicators, particularly with those outside the profession. (Have you ever been accused of explaining how to build a watch?)

On the other hand, we have a legitimate need to ensure that we provide advice that is reliable and supportable. ASOP No. 41 enshrines the requirements to ensure that our communication is complete and would allow another actuary to review and assess our work.

How do we reconcile these two needs? How can we become effective communicators with other business people, which requires us to simplify complex subject matters, without shirking our responsibility to provide the documented support on the analysis that led to our conclusions?

Has the Bar Been Raised?

Second, there is an apparent need to assemble far more documentation than appeared to be required under the previous version of the standard. Despite assurances that the revisions to the standard were not intended to place any additional burden on companies—and that the informality of internal communications is recognized—there is still a concern by some actuaries that "the bar has been raised." This arises from the question as to whether the intent of section 3.3 is to allow for discretion about whether or not an actuarial report is necessary or discretion solely about what would be required content for the report—in either case under Specific Circumstances.

How will you defend your decision not to provide a user with a comprehensive actuarial report?

The Final Word

If in doubt, document more, rather than less. In the event that you are attempting to reconstruct a project sometime in the future, you'll be happy you did!

If still in doubt, contact the Actuarial Board for Counseling and Discipline. There is a well-established process to get informal guidance from a member of the board, or to request more formal guidance if the matter so justifies.

Disclaimer: The author is not a member of the Actuarial Standards Board. These comments are the personal opinion of the author and do not necessarily represent the views of any other person or government body.

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March NAIC Summary

By Norman E. Hill

The National Association of Insurance Commissioners (NAIC) held its actuarial meetings in March, along with several other meetings. The following is a summary of these meetings and some of my general thoughts and perspectives. These thoughts reflect my views and not necessarily the views of the NAIC, the Society of Actuaries (SOA) or the Smaller Insurance Company Section.

In general, the NAIC is trying to answer criticisms from proponents of the Optional Federal Charter (OFC). Its primary device is the label "Solvency Modernization Initiative" (SMI) assigned to numerous meetings.

Some Key Points

1. I believe that, at this point, the main concern for small companies is the SMI movement to scrap statutory accounting, in favor of still very questionable international GAAP accounting AND international GAAP (IFRS) reserves.

2. Testing of the statutory CRVM reserve impact from current methodologies under principle-based reserves (PBR) is way behind schedule and could very likely not be completed this year.

3. One important PBR problem for small companies is unfavorable trends under Experience Reporting requirements.

Details

SMI-Statutory Accounting and IFRS Reserves

There was little discussion at the meeting about whether the convergence in accounting to a new system will be superior to the current system. Some U.S. insurers are owned by foreign parents that are used to only one accounting method. However, international GAAP—especially IFRS for reserves—still contains some objectionable elements to U.S. companies. The "Solvency 2" approach, now being tested in Europe using IFRS, and previously touted as superior to U.S. regulation, has been described as not working well. In the near future, Solvency 2 regulation is supposed to be compared against U.S. insurance regulation, to see if the latter is at least equivalent in quality.

In SMI conference calls, some U.S. regulators have said they wanted to retain regulatory control, rather than transfer complete financial reliance to a form of GAAP accounting. However, none of them have defended statutory accounting; nor have they pointed out the flaws in IFRS.

At this point, nobody has pointed out the difficulty in ignoring the Standard Valuation Law of all states and, somehow, requiring IFRS reserves instead. With an incredible amount of time expended in PBR discussions over the last six years, there would be recriminations from such a substitution.

The NAIC representative to these foreign bodies, Rob Esson, believes he may have made progress on one key point. He said the documents for international GAAP now use words like "economic valuation," which could be interpreted broadly to include "amortized cost" for assets and "current statutory" (which might include PBR) for reserves. In other words, definitions in international GAAP would be broadened to include U.S. statutory practices. I believe this may be too optimistic, partly because "economic value" has sometimes been defined or hinted at quite differently in the United States. Also, Esson already has met with resistance from the US Financial Accounting Standards Board (FASB) for this change, rather than from foreigners.

Actuarial/PBR

The former Life and Health Actuarial Task Force (LHATF) has been officially divided into two task forces, LATF for life and HATF for health.

There has been an ongoing study of PBR's impact on statutory reserves, which is proceeding. Towers Watson was appointed by the NAIC as actuarial coordinator to this study. Their current report indicated that, of the 41 participating companies recently surveyed, 13 indicated they would have results by the original March 31, 2011 deadline; another 13 indicated they would need more time—one to two months; one company opted out; seven didn't respond; and others indicated various questions and problems. Representatives of the actuarial firm said a form of preliminary report could be prepared as of June 30. However, they indicated there could be incomplete results, due to incomplete data.

So far, results in process are for Phase 1, intended as a form of impact study. Phase 2, intended as a form of "stress testing," is supposed to be completed by May 31of this year. It seems clear that the entire study will be considerably delayed. The original timetable of complete adoption of a tested Valuation Manual by the end of August 2011 wasn't changed by LATF or its PBR EX parent (in a subsequent meeting), but it seems unrealistic.

"The former Life and Health Actuarial Task Force (LHATF) has been officially divided into two task forces, LATF for life and HATF for health."

At least, the LATF still held true to its stated intent that no lobbying for passage of a new Standard Valuation Law would be made until the Valuation Manual is completed.

Experience Reporting

This phase of the Valuation Manual is under New York's control. They have very few small companies domiciled or admitted in the state. As a result, I don't believe they have much sensitivity for small company concerns, other than their apparent definition of "small" as under $10 million in premiums.

They have mandated mortality data collection from 60–65 companies, which is now in process. I have not seen that they have employed simplified reporting requirements for any smaller companies that may be included.

At the meeting, the New York Department sent in a request to the American Academy of Actuaries for format designs to be used in mandated collection of policyholder behavior (PB) data. This would be their next step. Mark Birdsall, FSA, MAAA, now chief actuary for the Kansas Insurance Department, summarized the following points:

1. PB is divided into several significant divisions, such as actual surrender, lapse and transfer to nonforfeiture status, paying lesser premiums under Universal Life (UL) and other policies, and other modifications.

2. Companies may often have data on surrenders, but not on the other policyholder actions.

3. Providing any of these splits should be quite costly.

4. LATF has apparently not made any cost benefit studies of providing PB data.

No one on the task force disputed the lack of a cost benefit study, but Chairman Leslie Jones, ASA, MAAA, said that Birdsall had made some good points.

SMI-Risk Based Capital (RBC)

This working group of the SMI Task Force prepared a draft of an assignment for the Academy. They had asked for help on 12 different, time-intensive studies of current RBC rules that were intended as a way to update these rules. Unfortunately, one of the Academy officers (from the property-casualty side), responding to the draft report, said that current RBC requirements may not properly identify all weak companies. Even so, another Academy officer said that this 12-point draft was impossible for the Academy to work with. They would need much more detail about what the working group wanted. Moreover, the Academy's resources were strained from other NAIC assignments. The chairman of the working group agreed that much more dialog was needed.

Other Areas Discussed at LATF

The New York Department made a written complaint that some companies are willfully violating the law by using gimmicks to reduce AG38 reserves on Universal Life with

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Secondary Guarantees (ULSG). Apparently, some writers have made changes to Shadow Account premiums, which are normally less than minimum premiums (de facto term premiums) required to maintain in-force status. By redefining the former premiums to be greater than normal minimum premiums ***and*** using the former in AG38 reserve calculations, ULSG reserves are thereby reduced.

This position of the New York Department actuaries is now under executive review by the New York Department, before any new ruling or publication is made.

Some LATF actuaries said that they might want to turn this matter over to the Actuarial Board for Counseling and Discipline for disciplinary action. Both the American Council of Life Insurers and the Coalition for Affordable Life Insurance are against this approach, at least until New York's official position is published.

For discussion, Dave Neve, FSA, CERA, MAAA, brought up again the question of required peer review of PBR reserves. Previously, this approach had been supported by the Academy, but then abandoned. Some actuaries support this approach, while a few are strongly opposed to it. Personally, I believe that departments would be forced to employ PBR reserve reviews by independent actuaries, amounting to peer review.

Separate accounts were also discussed. Large amounts of assets other than common stocks and many products other than variable ones are now included in these accounts. The suitability of these relatively new inclusions was questioned. While small companies may not be currently interested in separate accounts, their exponential growth in recent years may change this attitude.

HATF and Premium Deficiency Reserves

This type of reserve is now required for health policies. Based on comments at the meeting, I became concerned that its formulas and applicability were not uniformly understood.

In my opinion, the proper place for this reserve is for short-duration policies without policy reserves. When losses are projected over such short periods and premiums are guaranteed, the premium deficiency reserve would recognize resulting future losses.

For longer-term policies with policy reserves, these reserves are subject to asset adequacy testing. Gross premium reserves (GPRs) are compared to policy reserves, with the former based on current premiums (possibly, with reasonable rate increases included). If GPRs exceed policy reserves, additional reserves would be required.

In subsequent correspondence with a regulatory actuary, he emphasized that an Actuarial Practice Note treats these two liabilities as complementary. In other words, they should be set up on an either/or basis.

Summary

This article again highlights the need for all companies, including small companies, to maintain active monitoring of regulations that could bring substantial changes to the insurance industry.

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