



SOCIETY OF ACTUARIES

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It's Showtime! Some Decisions: Recent Developments with the ACLI Interim Proposal and the Principles-Based Approach

by Jim Thompson

Two valuation proposals have occupied the regulatory agenda this year—the ACLI Interim Proposal and SVL II (or the Principles Based Approach (PBA) to reserving). This began at the December NAIC meeting in Chicago. I was there, and I have followed most of the regulatory phone calls since then. I frankly have never seen any other significant proposals pushed along so quickly. Our newsletter attempts to keep you informed of regulatory events with enough advance warning so that you can see if you need to get involved in some way. Final copy for this issue had to be submitted before the September NAIC meeting. It is scheduled to reach you in November in advance of the December NAIC meeting.

Time Frame

Up to this point I had been under the impression that both the PBA, formerly referred to as PBR for reserving) and the ACLI Interim would be presented to the Life and Health Actuarial Task Force (LHATF) Sept. 7-8 in St. Louis and then passed in December. Randall Stevenson, the NAIC actuary, told me that PBA, if passed in December, would have to be exposed for two years (although this could be shortened to one year), then given two years for enough states to pass it and then the effective date would be two years beyond that.

The ACLI proposal is not a new law but an approach to changing Actuarial Guideline 38 to



allow lapse and to allow a new preferred mortality table (a breakdown of the 2001 CSO) to be used. The intent is to view it as a modification (not a change) of current law. Thus, it would take effect whenever the NAIC decided.

LHATF decided to actually vote on the Interim Proposal in a conference call on August 29. If passed, it would be possible for it to move quickly through the NAIC A-committee (life issues), Executive Committee and plenary and, thus, be voted on September 8! Since PBA will take a long time to implement, the ACLI Interim might be the regulatory approach for years to come. It is important to understand the implications and how things went on that phone call.

What Is the ACLI Interim Proposal?

The ACLI wants to allow preferred modifications to the 2001 CSO nonsmoker /smoker mortality tables. They produced some preferred factors by a study they paid for. One frequently expressed regulatory concern is that this should be peer reviewed or that another one should be produced through the Society of Actuaries. This was introduced as a draft actuarial guideline regarding the use of preferred mortality valuation tables.

A joint AAA/SOA Review Team reviewed these mortality tables. This team was charged by the

NAIC with evaluating the tables “in terms of applicability of generally accepted actuarial principles, practices and procedures” and endorsing them (modified if necessary) as a “reasonable basis for statutory reserves relative to the current 2001 CSO mortality table, if appropriate.”

Although they did endorse them, there was some significant qualifying language in the details of the report. In the conclusion they note the tables would be “used on an interim basis until such time as a long-term solution is provided.” The SOA is currently conducting such a study. Also under “Level of Preferred Mortality—Observations” the report notes that the 2002 survey which uses three non-tobacco classes and two tobacco classes, was based only on pricing mortality and not necessarily actual experience. “The ACLI Interim Table uses pricing mortality assumptions that may or may not be based on credible experience and which may incorporate mortality improvements as a basis for the mortality experience assumption in the underlying table.”

Another issue is the annual reporting of mortality to a statistical agent. If a company wishes to use these tables, it must “annually file with the commissioner, with the NAIC or with a statistical



agent designated by the NAIC and acceptable to the commissioner, statistical reports showing mortality” and other information. The commissioner may exempt a company from doing this.

Another issue is revising Actuarial guideline 38 (which is currently a preliminary draft with a sunset date of April 2007) to allow a 3 percent lapse assumption in reserve computation for UL with secondary guarantees. This is the first introduction of an assumption other than mortality and interest into the valuation process. Actuarial guidelines are supposed to clarify, not change, valuation laws. This appears precedent-setting.

The ACLI assembled a legal opinion to the effect that lapse could be allowed in this limited sense. Their proposed revision would allow it only with the permission of the commissioner. The NAIC’s attorney has concurred with the ACLI’s opinion on this, but many actuaries who are voting members of LHATF do not agree. They believe adding lapse changes the valuation law and does not clarify it. In calls leading up to August 29, this has been a major source of discussion.

Milliman was commissioned by the ACLI to produce a comparative study of the effect of their proposal with PBA and with current valuation. A hypothetical example of a UL was produced and overall the Interim reserves were 93 percent of the current (p. 4 of their report.). The ratio of the PBR approach to the ACLI is 88 percent based on their model assumptions. I find it hard to believe the ACLI is pushing so strongly for precedent-setting guidelines for such a small savings.

August 29: The Vote!

This phone call was actually designated for a vote. All 19 states that are members of LHATF were represented. There was a lot of parliamentary discussions of precisely how to propose the motion. Motions were withdrawn and reworded. An initial motion was only for the Preferred Mortality. This did not surprise me since I know the controversy the AG38 changes had caused. Eventually, however, they voted 11 to four to include both parts of the Interim proposal. Then they decided to vote (up or down) on the ACLI Interim proposal (both AG 38 and the preferred tables).

This was the dramatic moment. Before the vote there were several speeches, including one by California against including the 3 percent lapse. When the vote was tallied, however, it was 12 in favor and three opposed. The motion was made by Nebraska and seconded by North Dakota. Only Minnesota, California and Florida

voted no. A surprise “yes” was New York, and this elicited vocal surprise.

After it was all done, the chair, Mike Batte, used his prerogative to comment on what they had just done. He said they had voted for the politically expedient and this was not a function actuaries should do. Instead they should set high standards. He said commissioners are supposed to make the politically expedient decisions. Also he noted that an authoritative SOA preferred mortality table was possibly just three to six months away.

With the actuaries not objecting, it was not a surprise that it was passed (as two proposals: a revised Actuarial Guideline 38 and a Model Regulation, the preferred mortality tables for determining minimum reserves) at the fall NAIC meeting by the Executive Plenary. It is effective for policies issued on or after January 1, 2007 with a sunset date of December 31, 2010. It has a separate asset adequacy requirement. Will this passage have any impact on the other significant proposal, SVL II?

I believe the impetus for both moves is mainly the problems of over-reserving for XXX term and term-like UL products. These are mainly sold by stock companies. Supposedly the ACLI Interim proposal will satisfy their practical concerns. My impression of the conference calls on the SVL II is that there are many issues to be worked out. It is difficult to keep track of this. The calls are conducted with the emphasis on putting something together to show the NAIC in September. Sometimes points are raised and there is no definite vote on them. Issues were raised and there are some obvious disagreements.

On the August 31 call, the procedures whereby a regulator can request (demand?) that additional work could be done under current regulatory procedures and the SVL II, were discussed. Also there was a discussion on conservatism (by each policy or by each assumption or somehow in the aggregate). The need for haste in the time frame seems to expedite discussion. But in December, if a regulation has been cobbed together, will the different viewpoints assert themselves? If the Interim proposal is in place, because of the long time to pass the SVL II, will not some people try to put together a better version?

On the August 31 call someone said that we needed a good law but not a perfect one. But if the new SVL II represents a revolutionary change in the course of regulation, why not iron it out? My own guess is that the pace for passage will be slower. I look forward to seeing how the December NAIC meeting turns out. ●



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