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Small Talk Newsletter

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Regulatory Update

By Norman E. Hill

When we arrived in Philadelphia for the summer National Association of Insurance Commissioners (NAIC) meeting, we learned that weather conditions forced cancellation of the entire meeting. However, during the last week of August 2011, the Life Actuarial Task Force (LATF) had already held two conference calls on matters intended for Philadelphia. This article will summarize the current status of these discussions.

Experience Reporting

Makeup calls on this topic are scheduled for September. One significant development was an announcement from statistical agent MIB. They claimed that they could now absorb and process data from all companies in the industry, not their previous 250-company limit. For some time, this had been a small company concern—that compiled and submitted data to MIB would sit there, unused, due to the 250 maximum.

Another concern remains: the lack of LATF differentiation between dual functions of experience reporting; the compilation of industry experience tables and annual regulatory oversight on industry PBA reserve assumptions.

On industry experience tables, when one is to be prepared, several years of data are needed. Do regulators definitely wish to have companies submit this data each year, knowing that a table will be prepared in a few years? Alternatively, could companies retain this data in their own records and avoid annual submissions to MIB, if they certify retention?

On reserve assumptions, with current VM20 methodology, traditional products sold by smaller insurers should retain CRVM statutory reserves. Does it make sense to submit experience data annually, to serve as reserve tests on such products? If companies sell other products, does it make sense to retain all reserve assumption data and only submit it if their domestic department requests it (possibly from MIB summaries of several domestic companies in the same state)?

Currently, initial experience reporting requirements under VM50/51 only apply to "ordinary life" products, not to preneed, final expense, etc. But many smaller companies sell ordinary life as well. Other specialty products will eventually be caught up in data calls. Therefore, it would be helpful if the above problems are addressed for all products.

PBR and Industry Impact Study (also called "The Field Test")

After months of delay, the NAIC's consultant, Towers Watson, completed a report on Phase 1, a comparison of various reserves on key products. They said they are hopeful that Phase 2 calculations on sensitivity tests are proceeding faster, so that a report may be available by the winter meeting.

Traditional Products

The report had results for traditional whole life (TWL) products of only three companies and the same number of simplified whole life (SIWL) products. Most likely, at least two of the three TWL products were participating, while all three SIWL were nonpar. All three TWL products passed both the Stochastic Exclusion Test (SET) and the Deterministic Exclusion Test (DET), as defined in the PBR Valuation Manual (VM20). This means they would hold CRVM statutory reserves.

Two of the three SIWL companies also passed both tests, but one did not. This may reflect my fear that nonpar traditional permanent products may have more trouble with SET than par products. However, if asset durations matched against liabilities are fairly long, I believe there is still a good chance (not automatic) that nonpar products will pass the SET threshold of 4.5 percent ratio.

The report confirmed that the study used the theoretical SET approach, with at least eight defined interest scenarios (16, if stocks are included in asset portfolios). VM20 also allows an alternative shorter approach, relying on an actuarial study and certification that the product does not exhibit "material interest rate, tail or asset risk." This might be available from expanding asset adequacy projections, but still would require additional work.

The Towers actuary gave an extensive PowerPoint presentation, covering all points in the report up to the appendices.

In the meantime, the American Council of Life Insurers (ACLI) had hired Milliman to make its own study, corresponding to a form of Field Test. At this point, I have only read a few summary pages, but it did not seem to express disagreements with the Towers report. However, regulators stressed that this did not constitute an official supplemental report. They did not want a complete page-by-page summary of the Milliman document, although they understood the ACLI would likely refer to it.

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Other PBR Matters

Over the weekend, the ACLI requested in writing, due to some unexpected results from the Towers study, that the initial scope of PBR be limited to term (competitive term) and universal life with secondary guarantees (ULSG). Regulators briefly mentioned the letter without comment and did not as yet endorse it. Later, one regulator asked Chairman Leslie Jones what she thought of a LATF straw poll on scope. Leslie said, "No, not at this point." However, she did ask John Bruins of the ACLI to submit a proposal for an initial limited scope at the winter meeting.

It seems evident that, regardless of scope, the ACLI and its companies need additional time to study PBA reserve problems with the two plans in question—competitive term and ULSG. This type of testing could extend well into 2012.

Katie Campbell's proposal for more specific documentation steps under the Alternative SET was approved. It adds a series of guides for the actuary, rather than detailed calculations. These steps generally correspond to those currently followed by many companies under asset adequacy testing.

Originally, about 65 companies, mostly large ones, were asked to participate. Now, the Towers report showed results from 42 companies, if each company only submitted one plan. However, due to likely multiple submissions, the number of actual companies in the report may be considerably less.

As expected, PBR reserves for term on new bases, deterministic gross premium reserves (GPV) or stochastic (SR), were averaging less than CRVM statutory. However, on ULSG, the two former reserves were averaging higher than CRVM. This could be due to the contentious issue mentioned at the spring NAIC meeting, use of an alleged "shadow account" approach by some ULSG companies to produce CRVM reserves lower than some regulators believe are required under AG38.

This latter relationship, CRVM statutory versus GPV/SR, is surely what led to the ACLI's letter and recommendation. As for the AG38 issue itself, LATF had considered asking the American Academy and the Actuarial Board for Counseling and Discipline (ABCD) to look into possible action against actuaries of the above ULSG writers. Instead, based on several confidential regulator-only conference calls since the March meeting, they have sent out confidential surveys to all state insurance departments, requesting information on such reserve practices of their domestic companies.

PBR Outlook

The latest exposure draft of VM20 is dated Oct. 16, 2010. The ACLI, in its letter, talked about changes to VM20, in light of its reserve concerns. Earlier, the New York Department had also called for unspeci-

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fied changes in the way ULSG and term reserves are computed. Therefore, at this point, it seems almost certain that VM20 will not be completed this year. With ongoing instability, there remains the possibility that reserve methodology may turn out unfavorable for small insurers.

Other Issues

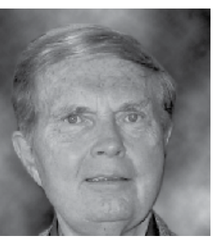
The American Academy has presented a new annuity mortality table to LATF. It is expected that, in a future conference call, the Academy will provide a complete PowerPoint presentation, describing the table.

LATF adopted the 2012 GRET Table, after the exposure period. These unit expense numbers are divided into broader marketing lines than before. The Society of Actuaries will consider how to make future line allocations more exact, given the limitations of published annual statement data.

In September and October, before the winter annual NAIC meeting, it is expected that other NAIC committees will hold calls. These groups deal with topics such as risk-based capital, international accounting, including the proposed International Financial Reporting Standards (IFRS) approach for insurance liabilities, and Solvency II to compare U.S. state-based insurance regulation with foreign single country regulation.

Summary

Cancelled NAIC meeting or not, there remains a host of issues and conference calls demanding the scrutiny of small insurers.



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