SOCIETY OF ACTUARIES

Article from:

Small Talk

March 2013 – Issue 39

Regulatory Update on Life and Some Health Insurance Issues as of Dec. 21, 2012

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As before, this material remains extremely time-sensitive. Before its publication, readers should keep up with blast emails from the Society of Actuaries and other published sources for new material that could affect items enclosed.

Principle-Based Reserves (PBR)—Approval Process

After seven years, this subject remains high on most lists. By now, everyone knows that the National Association of Insurance Commissioners (NAIC) Plenary has approved the package of a new Standard Valuation Law (SVL) and Manual (VM) for submission to state legislatures in 2013 to 2014. The A Committee had adopted an Aug. 17, 2012 version of VM, but, presumably, the Plenary intent on Dec. 2, 2012 was to adopt a version including numerous Life Actuarial Task Force (LATF) amendments adopted for exposure (by them) since Aug. 17, 2012. A comment from the NAIC president implied recognition of the importance of final adoption after all the years of effort.

> "I recommend that, in 2013 and 2014, actuaries try to monitor activity of their domestic legislatures, as to proposals for VM adoption."

The most current SVL version, with its 75 percent of premiums supermajority requirement, still specifies 2008 premiums. In any event, 2010 premium totals from the American Council of Life Insurers (ACLI) indicate that states with 23+ percent of premiums opposed Plenary adoption. If abstaining states are included, the opposition becomes 26+ percent. Several states were absent from the vote, which could also have an impact. This degree of support is far short of NAIC's normal desire for consensus.

To complicate further the question of approval:

1. At the November LATF, the ACLI proposed without a written amendment that VM expand its optional implementation deferral from three years to five years.
2. New York has evidently proposed that some period of parallel reserve calculations (three to five years) be used. Current statutory reserves would be calculated, officially filed, but compared with reserves under PBR. The department implied that this change might overcome its opposition.
3. The actuary for the state of Kansas has stated that he would only take testimony from two insurers before his legislature to ensure rejection of the VM package.

I recommend that, in 2013 to 2014, actuaries try to monitor activity of their domestic legislatures, as to proposals for VM adoption.

PBR—What to Do in the Meantime

With uncertainty of VM adoption, other articles have been prepared on what actuaries should study to gear up for PBR. My only recommendation now is that actuaries review carefully their current procedures for asset adequacy testing (AAT). A key question is whether asset adequacy reports can be used to satisfy VM20 (Requirements for Principles-Based Reserves for Life Products) requirements for the Stochastic Exclusion Test (SET). Interest, mortality, lapse and other assumptions may differ from Section 9 of VM20. Some actuaries use a 7.5 percent aggregate reserve margin to test deterministic reserves under AAT (based on LATF discussions from the 1990s.). The number of scenarios used in AAT may need expansion.

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Even before VM approval and implementation, regulators may be scrutinizing AAT reports more carefully.

Another PBR aspect will require monitoring by some companies. In VM20, reserves for non-variable annuities (VM22) and health insurance, including long-term care and cancer (VM25), remain under current statutory requirements. But the stated intent is that some new PBR requirements will be required. These may not be completed until VM adoption by legislatures is complete (although not implementation). In such case, PBR requirements would be decided by the NAIC alone.

As a reminder, VM retains several PBR methodologies and requirements that many small insurers consider essential:

1. Availability of an actuarial certification to satisfy SET.
2. Resultant retention of statutory reserves for traditional products, which should include some term and traditional accumulation universal life (once defined).
3. Preneed products remaining exempt from PBR reserve requirements.
4. For companies with less than $50 million in individual life premiums, exemption from mandatory experience reporting.

Other Plenary Matters

The new 2012 Annuity Reserve Table was adopted for submission to the states. This table applies to both deferred and immediate non-variable annuities. A key provision requires annual adjustments for mortality improvement factors. These will apply retrospectively and prospectively to all issues covered under the table. The retrospective application of mortality improvements may require enhancements for some valuation systems.

Fixed Annuities with Guaranteed Living Benefit (GLIB) Provisions

At the November LATF, there was considerable discussion on reserve procedures for these products. LATF was unable to choose from three options:

1. Retaining current valuation requirements under AG33—some have complained that this is too inflexible and results in redundant reserves. The "greatest present value" approach of AG33, without policyholder choice percentages, may overstate reserves.
2. Modify AG33 to allow use of these percentages for GLIBs.
3. Allow AG43, the guideline for variable annuities, for GLIBs. This would require stochastic processing, which might be unduly complex for small insurers.

Experience Reporting Under VM and Other Sources

Mandatory experience reporting will be required for life and health products of most companies, including preneed. In my opinion, it will be some years before any data calls will be made for preneed, final expense or home service products. Even so, actuaries should review requirements of VM50 and 51 for data formatting requirements and their ability to accumulate data.

So far, the New York Department has conducted a mandatory pilot program for individual life mortality, using VM50/51 requirements. It intends to try another application for policyholder behavior, lapse and more. Its special aim is to try to capture behavior rates under universal life with secondary guarantees (ULSG), since reserves for these products will be key under PBR implementation.

PBR and Captives

Use of captive insurers under NAIC regulations may not be relevant for small insurers, but the subject did arise recently and deserves a few points of discussion.

Both insurers and commercial companies have set up captives to hold property and casualty (P&C) liability reserves or reinsure life and health reserves. The NAIC recently issued a white paper discussing whether captives have been used to circumvent NAIC requirements for investments and reserves, such as under AG38. Once PBR is in effect, one of its aims is to eliminate perceived statutory redundancies.

South Carolina is one state with many domiciled captives. In my discussions with its actuary, Leslie Jones, she stated that they require captive adherence with all standard NAIC laws and regulations on investments, reserves and risk-based capital. But I checked my archives for work I had done with captives domiciled in another state. At that time, its captives were not tied to any of these standard laws or regulations.

Therefore, my only recommendation is that any small insurer considering captive formation should compare its advantages with PBR and also check special captive laws/regulations of the intended domicile state.

International GAAP (IFRS) and PBR

At first, this might seem unrelated to PBR and statutory reserves. But subtle proposals at the NAIC are still on the table for substituting, i.e., scrapping U.S. statutory accounting for GAAP. This would apparently mean the new, still not finally adopted, International Financial Reporting Standards (IFRS).

In my opinion, any GAAP substitution of statutory reserves, after all the PBR work years, would create a firestorm from many companies. But a brief mention of current IFRS provisions is appropriate:

1. Reserves would be gross premium reserves—if underlying statutory departs from current formulaic, the possible federal income tax exposure in itself would be a firestorm.
2. Premiums, claims, expenses and regular current components would be shown in income statements. But "premiums" would be a form of YRT amount, definitely not meaningful current premium amounts.

Summary

With no end in sight, actuaries from small insurers need to watch developments carefully, on a considerable number of fronts.

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