Small Talk

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Regulatory Update

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This article summarizes topics of interest from the National Association of Insurance Commissioners (NAIC) 2016 Fall National Meeting. The reader should refer to *www.NAIC.org* for a complete understanding of recent developments on these and other topics. This article does not represent an exhaustive list of the Fall National Meeting. The Fall National Meeting materials can be found at *http://www.naic.org/meetings1612/cmte_a_latf_2016_fall_nm_materials.pdf?1483906468075*.

COMPANYWIDE EXEMPTION

One development and some clarifications are noteworthy. First, the Companywide Exemption Drafting Group, a working subgroup of Life Actuarial Task Force (LATF), submitted an amendment proposal to modify the risk-based capital (RBC) requirement within the exemption. Currently, the conditions for qualifying for the exemption are:

1. The company has less than $300 million of ordinary life premiums and, if the company is a member of an NAIC group of life insurers, the group has combined ordinary life premiums of less than $600 million; and

2. The company must have reported total adjusted capital of at least 450 percent of the authorized control level RBC in the most recent report, and the appointed actuary has provided an unqualified opinion on the reserves; and

3. Any universal life secondary guarantee (ULSG) policies issued or assumed by the company with an issue date on or after the operative date of the Valuation Manual meet the definition of a non-material secondary guarantee ULSG.

The change being considered is to alter the wording in item (2) to limit the RBC criteria to apply to a company with *at least $50 million* of ordinary life premiums, while a company with less than $50 million of ordinary life premiums need not meet the RBC criteria, but must meet all other criteria.

This change is an attempt to recognize that smaller companies can have more volatile RBC fluctuations that could be cause for not meeting the criteria in a year after having met all the criteria in previous years. Although the change introduced by this drafting group was met favorably by LATF, it was not formally adopted because of other amendments that were introduced just prior to the Fall National Meeting. Two of these topics were mentioned in the Society of Actuaries (SOA)/American Academy of Actuaries (Academy) Post-NAIC webcast. The first topic involves clarification regarding whether a company that qualifies for and wants to file the companywide exemption may simply use the three-year transition period window in the initial years of 2017, 2018 and 2019 before actually filing the exemption with its domiciliary commissioner. This is a viable option for all companies considering the companywide exemption. The second involves clarification regarding the issue date on ULSG policies that do not meet the definition of a non-material secondary guarantee ULSG. Though it did not come through in the actual language found in the Valuation Manual effective for 2017 valuations, the regulators intended that the prohibition on ULSG policies would actually be effective as of the year the company files for the companywide exemption. As a result of these two clarification efforts and perhaps others, the Companywide Exemption Drafting Group's proposal will be further discussed in parallel with the recently submitted proposal forms, and action taken soon.

2017 CSO AND NET PREMIUM RESERVE (NPR)

LATF also has formed a Term NPR Drafting Group tasked with considering whether any changes to the NPR formula for term insurance are necessary, given the introduction of the 2017 CSO valuation mortality basis. During the months leading up to the Fall National Meeting, the American Council of Life Insurers (ACLI), together with some of its member companies, performed testing in order to help answer this question. During the presentation of the industry testing outcomes, the ACLI put forth three general principles for assessing the appropriateness of NPR for term insurance, which are paraphrased here:

1. The focus of principle-based reserves (PBR) should be the modeled reserve amounts. In general, the deterministic reserve component for term insurance should be higher than the NPR for term insurance products for the industry as a whole, thus permitting reserves to be principle-based.

2. The NPR formula must be suitable for use as a tax reserve.

3. The NPR should produce reasonable reserve patterns that appropriately reflect pre-funding, and ideally should follow the patterns demonstrated by the modeled reserve.

The observations that emerged from the testing indicated that, from results of a diverse group of 13 insurers, these principles were largely maintained, when the results of these insurers were taken together as a group. Some companies exhibited NPR greater than deterministic reserve while others demonstrated the reverse, and some a bit of both, depending on duration. Had the outcome been more heavily weighted toward the majority of companies demonstrating NPR greater than deterministic reserve, and thus not aligning with principle (1), the conclusion would have been to pursue changes in the NPR formula for the next version of the Valuation Manual. As it turned out, however, such changes were determined by the regulators as not necessary, at least for now, since the NPR (as determined using the 2017 CSO mortality tables) and deterministic reserve appear to be reasonably calibrated to the previously mentioned principles.

MORTALITY TABLES SPECIFIC TO GUARANTEED ISSUE, SIMPLIFIED ISSUE AND PRE-NEED RISKS

A joint group consisting of the Joint Academy Life Experience Committee and the SOA Preferred Mortality Oversight Group has been developing these tables. A status of each is summarized here.

Guaranteed Issue (GI)

A report from the joint group's work is nearly complete and regulators will wait to review this report before exposing the tables. A basic table and valuation table will be available, and both include only uni-smoke mortality rates. The loading on the basic table rates to get to the valuation table rates follows a structure similar to the 2017 CSO, and is characterized as approximately 17 percent. The tables are male/female/unisex, with a five-year anti-select structure for the basic table. The valuation table consists of ultimate rates only. At present, the working definition of "guaranteed issue" is:

> A policy or certificate where the applicant must be accepted for coverage if the applicant is eligible and the premium is paid with the exception of: (i) ineligibility due to issue age ranges; or (ii) lack of membership in the eligible group (i.e., association group).

If the policy acceptance criteria include an actively-at-work requirement, any health-related requirements or waiver of any underwriting requirements based on minimum participation thresholds (i.e., worksite marketing), then the policy is not considered GI. As of the writing of this article, the joint group's report was in peer review and the tables were ready for consideration by the regulators. Exactly how the GI tables will fit into the VM-20 requirements and whether the GI valuation mortality table will be required for nonforfeiture values are questions the regulators need to resolve once the joint group's report is ready for distribution. Look for these discussions during 2017 LATF calls.

Simplified Issue (SI)

A report from the joint group's work is underway. A basic table and valuation table will be available, and both include only uni-smoke mortality rates. The loading on the basic table rates to get to the valuation table rates is approximately 35 percent. The tables are male/female/unisex, with a 10-year select structure for the basic table. The valuation table consists of ultimate rates only. At present, the working definition of "simplified issue" has yet to be determined, and is the subject of a broader committee focused on the definition for SI and accelerated/automated underwriting. Development of the SI basic table is complete and the joint group is working on finalizing the loading in the SI valuation table.

Pre-Need

A report from the joint group's work is in peer review and will be available soon. A basic table has been developed and is ready for publication. The pre-need basic table includes uni-smoke mortality rates. The rates are available in male/female/unisex rates with a 10-year anti-select structure. LATF had previously determined that for pre-need valuation, the 1980 CSO mortality table should be used. Once ready, you can find the pre-need basic tables and the joint group's report on the SOA website at *https://www.soa.org/Research/Experience-Study/ind-life/default.aspx*.

NAIC PBR SURVEY AND PBR PILOT STUDY

The SOA and NAIC PBR Implementation (EX) Task Force jointly conducted a study on PBR implementation during the summer of 2016 and published the results in a report dated October 2016 found at *https://www.soa.org/Research/Experience-Study/Bus-Practice-Surveys/2016-mortality-implications-pbr-survey-part2.aspx*. The survey summarizes the responses of 72 survey recipients, 15 of whom provided more in-depth responses regarding plans to implement PBR for valuations as of 2017 for at least one product. The reader can gain a better understanding of the foothold of PBR and the 2017 CSO table usage during 2017, which products will likely be valued under PBR, and reasons for companies to elect to implement PBR versus not implementing PBR.

To be available near the end of January 2017 is a report on the NAIC's PBR Pilot Study. Eleven companies participated in this study, submitting VM-31 actuarial reports to their domiciliary regulators. To date, regulators have shared observations that the level of detail varies across the submitted VM-31 reports, and they have observed a wide variety of interpretations regarding how companies determine mortality segments and corresponding statistical credibility and sufficient data periods. Regulators feel this latter aspect merits further guidance within the Valuation Manual and will likely be spending time in the near term discussing the concepts of mortality segment determination, credibility and sufficient data period. Look for a final written report on the NAIC Pilot Study outcomes to be available on *www.NAIC.org* in the January to February 2017 time frame.

PBR TRAINING

There are many education opportunities specific to PBR. These publications were recently made available:

- Relative Risk (RR) Tool published by the SOA: *https://www.soa.org/Research/Experience-Study/Ind-Life/Valuation/relativerisktool.aspx*
- Impact of VM-20 on Life Insurance Product Development: *https://www.soa.org/Research/Research-Projects/Life-Insurance/2016-impact-of-vm20-product-development.aspx*
- Updated PBA Implementation Guide: *https://www.soa.org/Research/Research-Projects/Life-Insurance/research-2013-pba-implementation-guide.aspx*
- PBR Professional Development Series (free of charge to SOA members): *https://www.soa.org/prof-dev/ecourses/pbr-prof-dev-series/*
    - Credibility/ASOP 25 (available)
    - Application of Exclusion Tests (available)
    - Stochastic Modeling & Model Compression Techniques (available)
    - VM-20 Liability Assumptions Overview (coming soon)
    - Reinsurance (coming soon)
    - Product Development and Pricing under PBR (coming soon)
    - VM-31 Reporting (coming soon)
    - VM-20 Asset Assumptions Overview (coming soon)
    - Underwriting Criteria Scoring Calculator (coming soon)
    - Aggregation & Allocation (coming soon)

LATF VALUATION MANUAL REVIEW DRAFTING GROUP

This newly formed NAIC working group includes NAIC actuarial staff, Academy members, ACLI staff, and NAIC regulators at large. The focus of this group is to review the language of the Valuation Manual and audit it for consistency and also to receive and respond to questions from industry regarding the application of the Valuation Manual requirements. You can follow this activity by clicking through to the "Exposure Drafts" area of the LATF webpage at *http://naic.org/cmte_a_latf.htm*. Currently, there is a set of initial questions and responses exposed for consideration.

VM-22 DEVELOPMENTS

There are three important developments with respect to annuity contracts to note. LATF exposed for a 45-day comment period the VM-22 Subgroup's proposal to revise the determination of the maximum valuation interest rate for income annuities. The proposal will better align the valuation interest rate for these contracts with the current economic conditions and the duration of the liabilities being valued.

Work on VM-22, or PBR for non-variable annuities, continues. The VM-22 Subgroup had been considering an interim simplified floor reserve method, but has largely abandoned this initiative after learning results of field testing on the method. The proposed simplified approach produced reserves higher than CARVM, whereas the expected outcome was for reserves lower than CARVM, to offset the 100 percent utilization assumptions inherent in current CARVM. Rather than spend resources refining an interim simplified approach, the regulators chose to focus on a PBR modeling method that satisfies the requirements of the Standard Valuation Law and has recognition of a company's prudent estimate assumptions.

The VM-22 Subgroup continues to consider the ultimate design for PBR for non-variable annuities. Having once pursued a method called the "representative scenario method," this has been discarded in favor of a reasonable floor reserve, a modeled reserve, and some form of an exclusion test. The requirements being developed are expected to exclude payout annuities and apply to non-variable annuities with guaranteed living and/or death benefits. Follow the activities of the VM-22 Subgroup at *http://naic.org/cmte_a_latf_vm22sg.htm*.

2017 GENERALLY RECOGNIZED EXPENSE TABLES (GRET)

The 2017 GRET factors were adopted at the Fall National Meeting. The corresponding report can be found at *http://naic.org/documents/committees_a_latf_exposure_gret_rec_letter.pdf*. Compared to 2016 factors, the 2017 factors have increased, the distribution channel categories remain unchanged, and the number of companies included in the study has increased. ■

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