



SOCIETY OF ACTUARIES

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Regulatory Update for 2013

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This material is prepared as of Dec. 22, 2013. Since events in the industry remain volatile and dynamic, readers are strongly encouraged to read email blasts from the Society of Actuaries (SOA) and other industry publications up to the date of *Small Talk* publication.

1. SOA's role—It has been emphasized that the SOA's role is educational, rather than one of advocacy. Nonetheless, there can often be a fine line between education of actuaries on certain matters versus advocating a certain course of action on them. The following are examples.
 - a. At the National Association of Insurance Commissioners (NAIC) Fall Meeting, a new Individual Disability Table for active life and claim reserves was presented. It contains considerably more breakdowns of benefit and elimination periods than the 1985 table. The Health Actuarial Task Force (HATF) adopted this table, but with a long six-month exposure. One regulatory actuary asked the presenter a question that generated some controversy: Since report conclusions recommend higher active life reserves in three states—California, New York and Florida (for example, 29 percent higher in California)—what is the basis for this recommendation? The presenter said the statistics call for this split, but the HATF actuary said he needed more to present to his legislator.

This raises the question: Can an actuary prepare a qualitative report, based on surveys or interviews of contributing companies and other sources that address questions like the above? Issues could include: Existence of state disability programs—do these lead to higher income replacement during disability; are there legal differences in court decisions on disability definitions and claims practices; and are there cultural differences among states affecting attitudes toward disability?

b. Arguably, there are similar issues regarding VM20 of the Valuation Manual (VM), dealing with principle-based reserves (PBR), now up for legislative adoption in 2014–2015. Questions that could involve discussion between, and education of, actuaries include:

- (1) Section 2D4 states that only stochastic and deterministic gross premium reserves qualify as PBR reserves. But if the actuary expends professional effort in computing CRVM reserves and uses his judgment to test their adequacy, is this work also the type to satisfy PBR?
 - (2) For certain treatment under VM20, types of term and universal life with secondary guarantees (ULSG) require definition. Generally, this “term” is considered to mean very competitive term policies sold today. Could definition of such term involve premiums that generate two or more segments, as defined under Regulation XXX?
2. The NAIC approved a new section of the Model Law on Actuarial Memorandum and Reports, requiring that the report be submitted annually to the board of directors. Since this involves Model Law 822, it must go through the legislative approval process.
 3. Comframe or Common Framework (of Regulation) does not generally affect small companies. It primarily affects Internationally Active Insurance Groups (IAIGs). However, developments in this area do involve questions of federal charter proposals, which imply they merit some monitoring.
 4. Captive insurers—Generally, this does not affect small companies, although there could be an increase in usage here of captives or Special Purpose Vehicles (SPVs). Parents cede business to captives, expecting that reserves and/or investments can receive more liberal regulatory treatment.

Competitive term and ULSG reserves have led to the primary demand for PBR and reserve reductions. Also, these products seem to be the primary products ceded to captives.

An increasing number of states now have legislation authorizing captives. Several large writers of the above two products have stated that they believe captives will continue for new business, even after PBR becomes effective for new business. Some regulators believe that captives should be outlawed, once PBR is adopted nationwide. This led to an intense session at the Fall NAIC Meeting. The ACLI testified for captives and against any precluding legislation of this sort.

5. Status of Current Basis of Statutory Accounting—As written before, this accounting basis is codified, even though sometimes described as “GAAP except for.” If current U.S. GAAP is ever replaced by currently proposed international GAAP (IFRS), this codification would continue. Some small companies report on both statutory and GAAP, while some use only statutory.

Although some vague statements have been made about scrapping statutory accounting in place of some type of GAAP, no concrete proposals were made at the Fall NAIC Meeting.

One regulator expressed disappointment at lack of progress of convergence of two IFRS versions, one by U.S. accounting authorities (FASB) and one by international authorities (IASB). He said that now he wasn’t sure if such convergence would ever take place. At such time, the question of scrapping statutory accounting could rise again.

6. Actuarial Guideline 38 (AG38) and ULSG—This is an NAIC-agreed-upon basis for gradually grading ULSG reserves calculated by some companies up to quasi-PBR over the period 2011 through 2013 (or later). At the Fall NAIC Meeting, the New York representative on the Life Actuarial Task Force (LATF) did not report on any observations of ULSG reserve games or under-reporting. Given recent controversy and assertions of such practice, this silence was surprising.
7. Affordable Care Act (ACA)—Much has been reported in the news and television about current problems with “Obamacare.” One statement made about NAIC

goals for 2014 was helping states that are attempting to implement health coverage exchanges under the Act.

8. Optional Federal Charter (OFC)—Recently, a key federal agency, the Federal Insurance Office (FIO), issued a report calling for some degree of increased federal involvement in insurance regulation. Federal designations of AIG, Prudential and Met as systemically significant make them subject to such supervision.


It seems that NAIC executives have attempted to put a positive spin on these developments, since the FIO seems willing to work with and cooperate (somehow) with the NAIC.

9. PBR

- a. Non-variable annuities and long-term care (VM22 and VM25, respectively)—No firm proposals have ever been made for modifying current statutory reserves for these products. For VM22 annuities, a work group of the American Academy of Actuaries (AAA) has said again that they do not anticipate any radical departures from current statutory. They have indicated that they will propose liberalizations of CARVM, so that many low probability annuity benefit outcomes can have probability rates applied in reserving.

- b. Mandatory expense reporting—A key portion of VM is mandatory experience data reporting (VM50 and 51). Types of data reported would include mortality, involving activity to date, but also lapse (policyholder behavior) and expenses. New York, which has overseen LATF activity to date in this area, indicated again its interest in expense reporting. Reports would eventually go beyond current annual statements, so that acquisition, pricing overhead AND remaining overhead would be separated.

This type of split could be troublesome for many small companies. Due in large part to size and lack of critical mass, small insurers are apt to have substantial amounts of non-pricing overhead. If the latter were required in reserve calculations, without grading or similar relief, small companies



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could have a considerable disadvantage in the industry with reserve magnitudes.

- c. Industrial life exemption—Unexpectedly, the LATF chairman proposed a complete PBR reserve exemption for industrial insurance (to be defined). This proposal was adopted for exposure. As a result, industrial, preneed and credit life would be exempt from PBR reserves. Other traditional products, such as “vanilla” permanent, final expense, limited or guaranteed issue life and worksite life would not be exempt.

Exemptions under mandatory experience reporting are more limited. Companies with under \$50 million in ordinary life premiums are exempt. Also, small companies would often be exempt, under the NAIC goal in VM50 of limiting data collections to 80 percent of industry aggregate volume.

- d. ACLI proposal for small company exemptions—The ACLI made its initial proposal to LATF, but sent its covering proposal letter to the parent organization, EX PBR Implementation Task Force (ITF). The letter stated that the small company portion of ACLI, the Forum 500, supported such exemption and would only support PBR if it were adopted.

Exemption would depend on company premiums, risk-based capital (RBC) level, unqualified actuarial opinion on reserves, and minimal premium volume for ULSG. These thresholds were not specifically stated, but the goal was to exempt the 700 or so companies that comprise only 15 percent of industry volume.

One LATF actuary stated his adamant opposition to the proposal, and several other LATF members stated opposition. However, rather than reject the proposal, LATF deferred a decision to its parent, the above ITF. When ITF met the next day, its entire time was taken up with discussions on captives. Therefore, it promised to take up the ACLI

exemption proposal in a January 2014 conference call.

- e. Net premium reserve (NPR) expansion—One LATF member expressed his intention to propose that NPR be developed as the floor reserve for traditional products, replacing current CRVM. If developed, new NPR factors would be subject to a cell-by-cell cash value test. Since, for most products, cash values eventually grade to CRVM statutory, the latter would become the reserve floor anyway.
- f. Industry premiums by state and PBR legislative adoption—The new Standard Valuation Law (SVL) only becomes effective when states with 75 percent or more of aggregate 2008 life and health premiums have adopted it. The exact stipulation is premiums from both life and health insurers.

The ACLI Fact Book shows 2008 premiums for all lines of business, but only from life insurers. In its Table 10.6, this total is about \$739 billion. However, the NAIC-published threshold, that presumably includes health insurers, is significantly higher, a little over \$1 trillion. Exact state percentages to achieve the 75 percent goal vary somewhat between the two tables

- g. Legislative adoption status—For some time, the total number of jurisdictions adopting VM has remained at seven small states. Key states where PBR adoption will be considered start in 2014 and continue into 2015.

- 10. Contingent deferred annuities (CDAs)—This is another product hardly ever sold by small companies, but its popularity has been increasing. It is sold in conjunction with an investment product of some kind not sold by the insurer. When and if monthly income from the investment fund is exhausted, corresponding monthly income starts to be paid from the CDA. Some have questioned whether it is really an insurance or guaranty fund product.

So far, the NAIC and LATF have not devised any reserving or RBC methodologies for CDAs.

Summary

Year after year, every update report stresses the high degree of uncertainty remaining on a host of issues, both for small companies and the entire life and health industry. ●



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