Small Talk

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Regulatory Update

By Karen Rudolph

This material was prepared Dec. 12, 2015. At time of publication, actions noted in this article may have changed due to later regulatory meetings and decisions. Readers are encouraged to periodically check the *NAIC.org* website or refer to the Smaller Insurance Company Section website *(soa.org/sic)* to find the most recent news. Opinions expressed in this article are solely those of the author, and not the Smaller Insurance Company Section or the Society of Actuaries.

ITEMS OF IMPORTANCE FOR THE SMALLER COMPANY ACTUARY

This article includes items of importance in the regulation of individual life and annuity policies. Ever y company situation is different, making it difficult to pinpoint which of the regulatory developments is critical to the Small Talk audience. Readers will want to be at least peripherally aware of all developments; however, common areas of importance for smaller companies may include:

- Progress of state adoption of the principle-based reserving (PBR) legislation
- Planning for the 2017 Commissioners Standard Ordinary (CSO) valuation mortality table
- Proposed definition of a secondary guarantee and whether this impacts the company's plans for PBR implementation and/or product development
- Proposed clarification of the Net Premium Reserve (NPR) method for purposes of calculating the deterministic exclusion test
- Following the progress of the simplified issue, guaranteed issue and preneed valuation mortality tables

PBR STATE ADOPTION STATUS

Currently 39 states representing 71.78 percent of premium, measured as stipulated by Section 11 of the Standard Valuation Law (SVL), have adopted the SVL and Valuation Manual providing for PBR methodologies. These states are: Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Vermont, Virginia, Wisconsin and West Virginia. The version adopted by each state will be reviewed to establish whether the language provides for "substantially similar" provisions when compared to the model law of the National Association of Insurance Commissioners (NAIC). Only those states in which the adopted law is deemed substantially similar will be counted toward the 42-state and 75 percent of premium totals.

FALL 2015 NAIC MEETING

The focus of the following paragraphs is the Life Actuarial Task Force (LATF) of the NAIC and activity taken at its meeting held in November 2015. Please refer to *www.naic.org/committees_a_latf.htm* for more detail.

Valuation Manual Version

In recent months, updated versions of the Valuation Manual have been more frequently posted to the NAIC website. The version currently available includes language consistent with the adoptions of LATF and (A) Committee as a result of the November 2015 meeting. This language is found as tracked changes in the document and denotes provisions adopted by LATF and (A) Committee, but not yet adopted by NAIC Executive and Plenary. Many of these newly adopted provisions are noted in the following paragraphs.

2017 Commissioners Standard Ordinary Mortality Table

Language implementing the 2017 CSO mortality table for nonforfeiture was adopted into the Valuation Manual. For nonforfeiture, the 2017 CSO is required for policies issued on or after Jan. 1, 2020. For policies issued on or after Jan. 1, 2017, and prior to Jan. 1, 2020, the 2017 CSO is available for use at the company's option. Similar to current rules, the preferred version of the 2017 CSO is not available for use in calculating nonforfeiture values. These provisions can be found in VM-02 Section 5.A.

For statutory valuation, the 2017 CSO will become the minimum standard for policies issued on or after Jan. 1, 2020, and may be used for policies issued on or after Jan. 1, 2017, and prior to Jan. 1, 2020. These provisions can be found in VM-20 Section 3 and VM-M. Conditions for the use of the 2017 CSO Preferred Structure tables are similar to conditions for the use of the 2001 CSO Preferred Structure tables (Model 815). For companies electing to establish minimum reserves under VM-A and VM-C for business otherwise subject to VM-20 and issued during the first three years following the operative date of the Valuation Manual, Section II of the Valuation Manual under Life Insurance Products now provides for the 2017 CSO at the option of the company.

VM-20 Mortality Credibility and Margin Provisions

Mortality credibility measurement follows a prescribed methodology. For valuations in which the industry table is the 2015 Valuation Basic Table (VBT), the company has the option of using one of two methods:

- The Limited Fluctuation method by amount, with the relative error in the estimate being 5 percent, with a 95 percent probability
- The Bühlmann Empirical Bayesian method by amount

Each credibility method has a table of prescribed mortality margin percentages. The percentages vary by attained age and credibility level within the given table. For example, for attained ages less than 47, the Limited Fluctuation method margin is 10.0 percent for credibility of 43 to 47 percent. The Bühlmann method margin is 10.3 percent for credibility of 78 to 82 percent. Companies may want to evaluate credibility under each method. The prescribed grading of company rates with margins to industry rates with margins does not vary by credibility method.

VM-20 Default Cost Tables

An update to the VM-20 asset default cost tables was adopted. These tables are developed using Moody's data through December 2014. With the inclusion of more recent data, many of these prescribed cost factors have increased when compared to the earlier table.

Valuation Manual Amendment Proposals Exposed for Comment

Many amendment proposals have been submitted and exposed for comment. These proposals are important clarifications and refinements to the requirements of the Valuation Manual. To be clear, these are proposals, not adopted changes.

- The definition of the term "secondary guarantee" as a guarantee that a policy will remain in force for more than five years (the secondary guarantee period) even if its fund value is exhausted, subject to one or more conditions. This definition, together with the footnoted condition regarding secondary guarantee periods of five years or less, is consistent with the definition of secondary guarantee found in Model 380, Section 3.
- A proposal clarifying assumption modifications made to the NPR calculation when performing that calculation for purposes of the Deterministic Exclusion Test for term insurance policies—specifically, that annual lapse rates are 0 percent and the shock lapse rate at the end of the level premium period is 100 percent. For annually renewable term policies, the test should consider premiums for the duration of the policy. Lastly, if using the mortality that the company expects to emerge produces a net premium greater than the net premium that would be produced when using the valuation mortality, the company shall use the mortality it expects to emerge in determining the net premium for the exclusion test.

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- A proposal specifying the determination of the PBR Credit Rating for commercial and agricultural mortgage loans. For these mortgages, the company uses the numeric rating corresponding to the NAIC CM or commercial mortgage category that is assigned by the company consistent with the NAIC RBC instructions. This numeric rating would be used to point to the appropriate PBR Credit Rating in VM-20's Table K. The link between the CM designations and PBR Credit Rating already exists in Table K. For example, an NAIC CM designation of "1" equates to a PBR Credit Rating of "7."
- Because all the tables found in VM-31 are also part of the annual statement blank, a proposal has been submitted for changes to the requirements of VM-31 whereby the tables are removed. Without this proposal, the tables from the annual statement would be duplicated in the PBR Actuarial Report.
- The scope of the PBR Actuarial Report required by the Valuation Manual and specified in VM-31 is proposed as being required only for those companies that compute a deterministic reserve or stochastic reserve for any in-force policies. For companies that do not compute any deterministic or stochastic reserves as a result of passing exclusion tests, these companies must also develop the PBR Actuarial Report, but only the sections pertaining to the exclusion tests.
- VM-20 includes many references to the phrase "minimum reserve" in places where, under the current requirements, "modeled reserve" is intended. There is also a proposed change to the language specifying the starting asset requirement. In the current version, the requirement states: "If for all model segments combined, the aggregate annual statement value of starting assets is less than 98% or greater than the larger of NPR or 102% of the final aggregate modeled (whether stochastic or deterministic) reserve. …" The proposal removes the NPR reference and the parenthetical.
- A proposal to remove any reference to "seriatim reserve" and instead use "modeled reserve." The reference to seriatim reserve is left over from a much earlier time in the history of VM-20.

VM-22

The VM-22 subgroup working on developing PBR for non-variable annuities is leaning toward a minimum reserve definition as the greater of a formulaic reserve and modeled reserve. They also intend to have an exclusion test defined specifically for non-variable annuities. Whereas at one time this group was pursuing a method termed "Representative Scenario Method" for the modeled reserve component, this method has been dropped for the time being.

Joint Project Oversight Group—Guaranteed Issue, Simplified Issue and Preneed Mortality Tables

LATF heard an update on the development of these tables and the loading of each. There remains work to be done on these tables before they are ready for use in the industry.

For guaranteed issue (GI) business, an experience table and a draft of the valuation table have been constructed. Work continues on finding the appropriate loading levels.

For simplified issue (SI), the group is considering data collected from 30 companies. Even with this number of companies, there is a shortage of applicable data at longer durations and younger ages. The group expects to develop a full 25-year select and ultimate table. They are looking for industry feedback on appropriate loading structures and valuation standards for business issued with this underwriting type. The SI underwriting framework and tools have changed rapidly in recent years, making the data used to support these tables somewhat out of step with current SI procedures such as prescription drug scoring and other scoring algorithms.

Preneed insurance data submitted by the industry represent a high percentage share of the industry, despite the fact that only 11 companies contributed such data. The data is primarily unisex, so the team expects to first develop unisex preneed tables, then develop gender-specific tables after establishing the loading structure. As with SI, the team is looking to industry and LATF on appropriate levels of loading should the table be used for valuation.

PBR Pilot Project

The PBR Pilot Project is under the authority of the PBR Review Procedures Subgroup. The project will enlist many participating companies as well as regulators, and will be a pilot focused more on the process than on the reserve outcomes. The companies will be producing the PBR Actuarial Report as outlined in VM-31 as part of the pilot, the PBR supplement for the annual statement, as well as computing reserves and exclusion tests according to VM-20. Companies will be asked to apply VM-20 to various product types over several years of assumed new business. The goal of the PBR Review Procedures Subgroup is to have the companies on board in time to perform this work with a completion date of year-end 2016. Through this process, the American Academy of Actuaries and SOA working groups familiar with the PBR process and requirements may be called on to assist with clarification questions.

NAIC to License Modeling Software

The NAIC is currently evaluating actuarial modeling software for its use in moving to a PBR valuation environment. Having such software available is expected to address concerns that a principle-based environment with modeled reserves will complicate the audit process. The software will support the exam process, helping the NAIC to better evaluate and calibrate company models. The NAIC is staffing up to address PBR needs. Actuarial staff hired specifically to address PBR needs going forward will work with the Valuation Analysis Working Group (VAWG) to encourage states to apply uniform interpretations and consistent application of PBR requirements.

Actuarial Guideline XXXIII

The actuarial guideline "Determining CARVM Reserves for Annuity Contracts with Elective Benefits" (AG 33) had previously been amended by LATF, and these amendments were adopted in September 2015. NAIC Executive/Plenary adopted these changes at the 2015 Fall National Meeting. These edits specify that actuarial judgment should be used in determining the appropriateness of applying any non-elective incidence rates other than mortality. These changes impact valuations for 2015 year-end. The amended guideline can be found on the *NAIC.org* website and also in the *Accounting Practices and Procedures Manual.*

NAIC Streamlining Project

The NAIC is working with Actuarial Resources Corporation to develop a template to improve the structure and flow of statutory actuarial reporting. At present, a company reporting on a statutory basis may have up to 19 separate actuarial reports or submissions for the ordinary life and annuity lines of business. This makes for cumbersome review from the regulatory side, and for an overabundance of reports from the company side, with much duplication. The streamlining project seeks to develop a template a company can use to organize and submit its actuarial reports efficiently in a logical package, easing the submission to states. Several companies are on board with respect to beta testing the proposed template. ■

Karen Rudolph is principal and consulting Actuary at Milliman Inc. in Omaha, Neb. She can be reached at ***karen.rudolph@milliman.com***.