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**REINSURANCE RESPONSE TO GUIDELINE XXX  
AND NEW YORK REGULATION 147**

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*This forum will discuss the developments with regard to reinsurance response to New York Regulation 147 and Guideline XXX. How are reinsurers treating their reserve problems? How are these regulations affecting direct company products? Are there practical steps that can help?*

MR. ROBERT J. REALE: This is an open forum and I encourage you to ask questions and make comments. I'm an actuary at North American Reassurance and I'm the moderator for this session. I've been at North American Reassurance since 1989, and I'm primarily involved with pricing and marketing ordinary life and annuity, traditional and nontraditional reinsurance.

Although this program is the reinsurer's response to Guideline XXX and Regulation 147, our panel will discuss both the reinsurer's viewpoint and the direct company's viewpoint.

Our first speaker will be Rachel Hancock. Rachel is a consulting actuary at Tillinghast. She's currently in the process of moving from the New York office to set up a life practice in the Denver office. Rachel has been with Tillinghast for five years and worked at Metropolitan before that. Recently, Rachel has been analyzing the impact of Guideline XXX and Regulation 147 on several client companies' products and proposed products. Rachel was also involved in the implementation of Guideline XXX in the Tillinghast Actuarial Software (TAS) asset/liability modeling program. Her other areas of work expertise have focused on corporate financial reporting, embedded value, asset/liability management, and capital management.

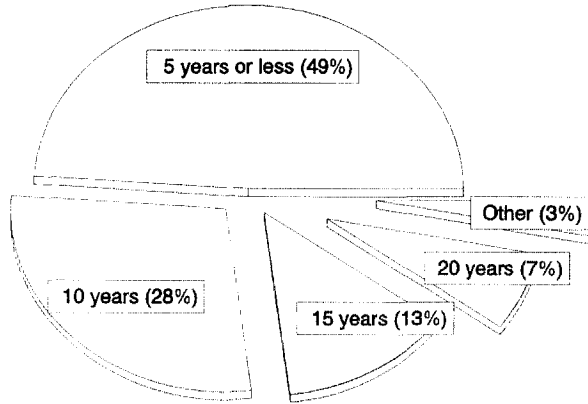
MS. RACHEL M. HANCOCK: The topic of this session is Guideline XXX and, in particular, the reinsurers' response to Guideline XXX. My presentation is on where direct companies are today and where they are going. I think it's what the direct companies do with their products that will drive how reinsurers will respond to Guideline XXX. I'm going to do this presentation in three parts.

I will start by looking at the kinds of term products that we are selling today. What are the types of products, the premium guarantees, the premium levels? We'll get a feel for how Guideline XXX will impact these products and what the magnitude of the impact is likely to be. Then I'll get into some of these products in a bit more detail and look at specifically how Guideline XXX will affect reserves, surplus strain, and profitability. And then from there, we'll go to what we think companies are going to do after Guideline XXX and what those products will look like.

To start with, I've taken a sample of 121 products from the Tillinghast database. I've split these products to see how many products have premium guarantees that are five years or less versus the longer-term guarantees that are primarily affected by Guideline XXX.

In Chart 1, the longer-guarantee products have been and continue to be the hot selling products in the term market. In particular, the ten-year term product is probably the most popular, but certainly there are many 15-year and 20-year products out there as well.

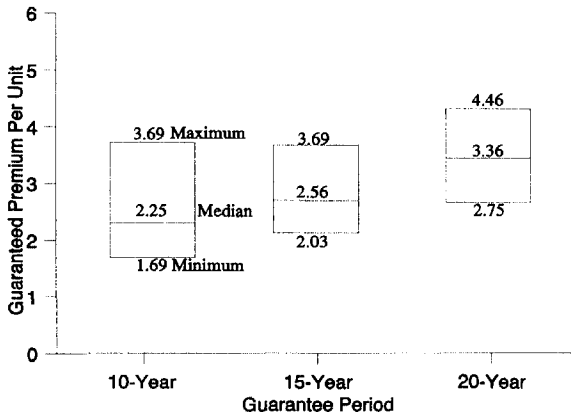
CHART 1  
PREMIUM GUARANTEES FOR 121 PRODUCTS



Source: Tillinghast's WISDOM

The range of premiums for some of these products is shown in Chart 2. I think there are several of things to learn from this. First, the premiums in this market are very competitive. The low end of these ranges represent the more competitive preferred classes. Later on we'll look at what the Guideline XXX valuation premiums look like relative to these premiums so that we can get an idea of what the premium deficiencies are going to be once Guideline XXX comes into play and what that means for deficiency reserves.

CHART 2  
GROSS PREMIUMS FOR AGE 45 NONSMOKER, \$250,000



Source: Tillinghast's WISDOM

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So what is Guideline XXX doing to these products? I think there has been quite a lot in the press during the last few years. The main point is that Guideline XXX is going to result in higher reserves for some of these longer-guarantee products. That's going to translate into higher surplus strain and lower returns on investment. To maintain current returns on investment, the premium increases that people have been talking about are somewhere between 10% and 25%, depending on the guarantee and the age. The other big point, of course, is that companies will be on a level playing field in terms of reserving practices once the regulation is adopted uniformly across all states.

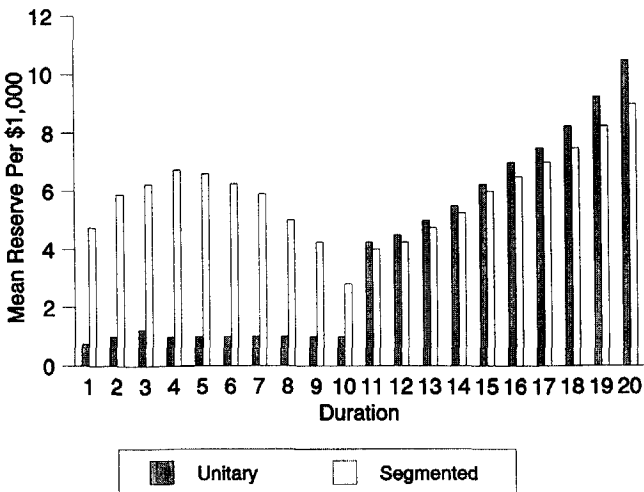
One article suggests that longer-guarantee products will stick around because despite Guideline XXX, these are the products consumers want. Subject to how much the premiums go up, these products will still sell. Not everyone is going to go to the five-year guarantee product.

What is the magnitude of reserve increase and what does it mean for surplus strain? I'm going to show an example so that we can look at what Guideline XXX means relative to the current unitary approach that many companies are using and get a feel for the magnitude of these reserves.

The example I'll take will be the ten-year term product which is probably the most common product that's being impacted. It'll be a product for a preferred nonsmoker. The sample premium is fairly competitive, but certainly not the most competitive. The premium is level for ten years and is guaranteed, followed by high YRT rates.

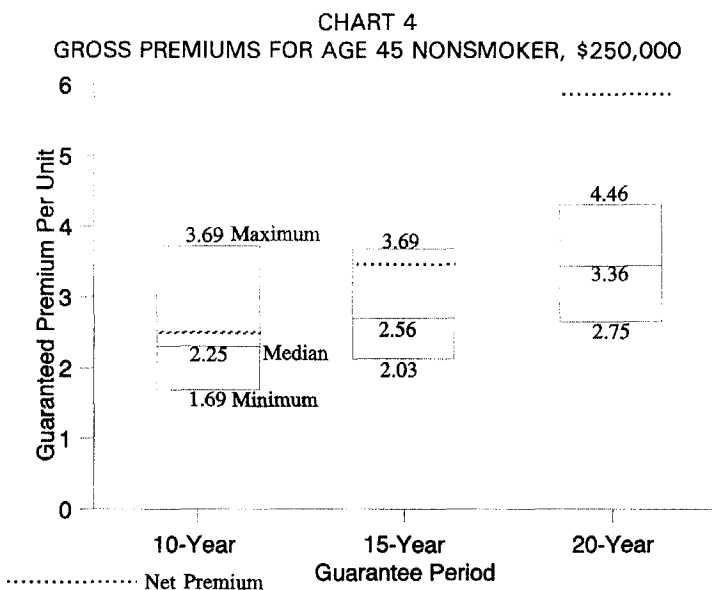
The unitary reserves are fairly low early on (Chart 3) because of the steep scale in premiums after the ten-year period. Guideline XXX, on the other hand, requires you to segment, so you're holding essentially ten-year term reserves. You end up with much higher reserves, and this is a combination of both higher basic reserves as well as deficiency reserves. I think the point here is the magnitude.

CHART 3  
EXAMPLE: TEN-YEAR TERM



In this example, the extra reserve we're talking about is about \$4.50 per unit, which adds an additional 200% of premium to the initial strain. Although that's pretax, much of this additional reserve is deficiency reserve that's not tax-deductible so it may be high after tax as well.

Just to get a feel for what it might do to the 15-year and 20-year products, let's look again at the range of current premiums along with the deficiency net premium under Guideline XXX by using 120% of the new select factors (Chart 4). The impact is even more pronounced with the 20-year premium product. So there certainly will be substantial deficiencies that will arise on those products.



Source: Tillinghast's WISDOM

To summarize the impact, higher reserves on these products translates into higher surplus strain. Obviously, that means return on investment is going to go down, but I think companies are planning on raising premiums to some extent to support the additional reserves—how much remains to be seen. But I think the real point here is that no matter how much you increase the premiums to get your ROI back up, the additional strain is not going to go away. It's somewhat less in the example, but the additional strain will still remain.

Looking at our 10-year-term example, what was the initial strain and ROI on that product? How does it change under Guideline XXX? And then what happens as you increase premiums? A current product might have something in the 100–110% initial strain and an ROI of 11% over a 10-year period. If you move straight to Guideline XXX reserves, the strain goes up above 300% of premium and the ROI has dropped to 7.5%.

TABLE 1  
HIGHER PREMIUMS WILL BE NEEDED TO SUPPORT COST OF RESERVES

	Unitary Reserves	XXX Reserves	XXX Reserves
Current premium	\$2.00	\$2.00	\$2.20
Guarantee period	10 years	10 years	10 years
First-year strain *	108%	321%	223%
ROI after target surplus	11.1%	7.5%	10.2%

\*Distributable earnings in first policy year divided by premium issued.

So I think companies are going to reprice these products to get ROIs back up. I think the real point is not that you can increase premiums to get the ROI up, but you're still left with an extra 100% of premium surplus strain even after you've done that. So if you're a company continuing to write this business, you're certainly going to have to revisit capital management and capital planning. And, for any company, even well-capitalized companies, if you're selling a lot of term, an extra 100% of premium is noteworthy.

After Guideline XXX, many companies will go to a five-year guarantee. At the same time, I think some companies will offer several products: the five-year product at the same premium and a higher-premium, 10-year-guarantee-type product. The market will stay fairly competitive. Companies have different ROI targets and different capital positions so I imagine that the types of premium increases we'll see will vary quite a lot. Obviously, well-capitalized companies will have an advantage. Of course, reinsurance will play a key role in trying to address the concerns and needs of the direct companies continuing in the market.

MR. REALE: Our next speaker is Neil Gerritt. Neil is an actuary at Equitable. He's been at Equitable for about 15 years and just went through the process of pricing a term product. He's going to share his thoughts on the process with us.

MR. NEIL GERRITT: I've been asked to speak briefly to you about our experience with our 10-year term product. We introduced a 10-year level term product last year. We put out two versions. Outside of New York, it's a standard 10-year level term product that is similar to the one Rachel described; 10-year level guarantee premium and a YRT renewal scale. The New York product was done with Regulation 147 being assumed. On a current basis, it's the same product. On a guarantee basis, we only guarantee the level premium for five years.

A previous version of Regulation 147 was more onerous than the current one. Particularly the number of calculations to do reserves has been decreased greatly with the current version of Regulation 147. Fortunately, it's much more similar to Guideline XXX at the moment.

Basically, we found much higher reserves under the ten-year term product. However, we find that with a five-year guarantee product, we don't get as large a difference in our return under Regulation 147 than what we get under unitary reserves. When we originally

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looked at the product, we thought we had about a 500-basis-point difference in our internal rate of return (IRR). With the changes in the final version of Regulation 147, we found that our difference was approximately 200 basis points. We've now been looking at the product with Guideline XXX to see what we're going to sell nationwide. We find that under the current version, what you do with your guaranteed premiums will make a big difference.

We haven't instituted any changes yet, but we've been looking at things that we can do. With proper choice of our guaranteed YRT scale, I've gotten the difference in the IRR down to about 40 basis points. There is very little difference when I look at things such as present value of profits.

As I said, I would like to stress the point that I don't have any secrets that I would like to give to you about what you should do with your YRT premiums. I've just begun to really look at them, but I do find that it now makes a lot more sense to take the time to prepare them properly. I have looked at things such as using select and ultimate scale on my YRT premiums rather than attained-age scales. I haven't mentioned this to any systems people yet.

We haven't actually determined what we're going to do nationwide when Guideline XXX comes into effect. Some of it will depend on what the market does. If companies with 10-year term products increase premiums, we may be willing to enter the market in that way.

We're probably looking at going with the five-year product. It's true that people do like longer guarantees and there is some pressure from the sales force to do that. However, there's more pressure to have competitive premiums.

MR. REALE: I'm pleased to introduce the third speaker who will be presenting much of the material on the reinsurance response to Guideline XXX and Regulation 147. Frank Clapper is the appointed actuary for Life Reassurance Corporation of America and is responsible for the earnings analysis and business planning as well as valuation. He has worked in valuation and reinsurance for 20 years, having served as valuation actuary for two other reinsurers besides Life Re. He has also worked in valuation at both Prudential and the Equitable and has done audit and examination work as a consulting actuary with Ernst & Young.

MR. FRANKLIN C. CLAPPER, JR: I will be talking to you about reinsurance, Regulation 147, Guideline XXX, and valuation in general. Reinsurance will be in there, but it's not the only thing I will talk about. I would like to give you some of my thoughts on how we got ourselves into this mess, and then I will wrap up by explaining how reinsurers can help you get out of it.

I am now a valuation actuary, but I haven't always been a valuation actuary. During the early 1980s, I spent three years as a reinsurance pricing actuary. Although I did enjoy meeting clients and coming up with creative ideas, some of the thinking involved in pricing reinsurance at that time seemed a little bit irrational to me. I deliberately switched careers to become a valuation actuary. I thought that valuation work would be more heavily based on clear thinking. I was a little bit naive about that.

## REINSURANCE RESPONSE TO GUIDELINE XXX AND REGULATION 147

As actuaries, most of you are aware of the difficulties of explaining to your friends and acquaintances what you do for a living. Being a reinsurance valuation actuary, when I go to a party, if somebody asks what I do, it takes almost the whole time at the party to explain it. First, I explain what actuaries do, generally. Then I say that a reinsurance company insures other life and health insurance companies. And because this person probably has insurance, he thinks he knows what that means. But then he asks, "What do valuation actuaries do?" "Well, we calculate reserves." "What's a reserve?" "The reserve is the amount we need to set aside to cover future benefits not provided for by future premiums. Usually on a life insurance policy the premium is higher than the cost in the early years and is not enough to cover benefits in each of the later years. So we have to set aside profits from the early years to make up the shortfall in the later years." Then my acquaintance really thinks he understands what I do for a living. More on this later.

I assume you are familiar with the major provisions of Regulation 147, but I would like to briefly highlight those provisions that affect typical reinsurance arrangements. First, if both the ceding company and the reinsurer are New York companies, then all provisions of Regulation 147 affect both companies equally. The reserve standards for coinsured business are the same for the reinsurer and the ceding company.

With yearly renewable term reinsurance, the reinsurer may still use the traditional valuation technique whereby each year's net premium is set equal to the lesser of the tabular cost and the guaranteed gross premium. Use of the new select mortality factors is not allowed in that case. In other words, it is business as usual. Nothing has changed on YRT. However, to qualify as YRT, both the current and guaranteed YRT rates must be "independent" of the reinsured plan rates. That's where it sometimes gets a little tricky. This means that they cannot automatically float up or down in proportion to changes in the rates of the reinsured plan. In any event, the ceding company's reserve credit cannot exceed what the reinsurer is holding.

For business for non-New York ceding companies, a New York reinsurer is allowed an extra year, i.e., January 1, 1995, before the contract segmentation method is required as a minimum on new business.

If a New York ceding company cedes business to a non-New York reinsurer, the reinsurer does not have to comply with Regulation 147. However, because of Regulation 20, the ceding insurer cannot take reserve credit for more than the amount held by the reinsurer. As a practical matter, then, even non-New York reinsurers must follow Regulation 147 with respect to business assumed from New York ceding companies.

This session focuses on a reinsurance response to Guideline XXX and New York Regulation 147. We'll get to Guideline XXX soon, but our response, then, to Regulation 147 is to hold the proper reserves for each situation. With coinsured business, this may require a heavy surplus investment if the segmented reserves are higher than traditional reserves. To manage surplus, we must charge an extra cost for the heavier surplus investment. However, in general, this has not caused any difficulties between our clients and us. I checked with our marketing people because I wanted to make sure. Rather, the responses from ceding companies have usually followed one of three paths, which is sort of like what Rachel was talking about. (1) Redesign: many of our New York clients have redesigned their products so that the heavy surplus strain is eliminated altogether. So there's no particular problem on reinsurance. (2) YRT: non-New York companies have

generally accepted our suggestion to use YRT. (3) No Change: some of our clients, even some of the non-New York companies, have insisted on keeping longer-term level premium guarantees as a marketing tool, and they prefer coinsurance to YRT. They're quite willing to accept the additional reinsurance cost as a necessary cost of doing business.

The NAIC's equivalent to Regulation 147, known as Guideline XXX, was passed in March. Of course, as with any model regulation, it remains to be seen how fast the various states will pass it and whether they will modify it. The model regulation, as passed at the NAIC level, still includes some significant differences from Regulation 147. I won't go into detail because these are already covered in the March 1995 *Actuarial Digest* and elsewhere.

None of the differences between Regulation 147 and Guideline XXX are unique to reinsurance, but the very fact that different states have different valuation requirements is enough to give any reinsurance valuation actuary a headache, because it often means calculating reserves differently from my client. During the past 15 years, reinsurers have grown accustomed to basing their reserves directly on numbers generated by the ceding company. Thus, our cost of doing business (and I mean "ours" together) will be increased as we are forced to obtain more detailed data from clients to recalculate the reserves at the reinsurance level. We are managing to cope with this problem by automating the flow of data and by using various estimation techniques, but I believe this additional burden should not be necessary.

Enough about reinsurance problems. Let's consider whether Regulation 147 and Guideline XXX have had or will have their desired impact. What was the purpose of Regulation 147? According to the preamble of the regulation, the purpose was to prevent companies from using artificially high premiums in later years to decrease reserves below adequate levels. Guideline XXX simply says its purpose was to provide new rules. Presumably, the new rules are needed for the same reason they are needed in Regulation 147.

What caused this problem? Superficially, the cause was the fact that some companies were taking advantage of a perceived loophole in the Standard Valuation Law to hold inadequate reserves. I use the word *inadequate* because, whether or not you agree with the valuation methodology in the regulations, it does seem rather obvious, as Regulation 147 states, that a level benefit life insurance policy with level premiums for 10 years, followed by ART thereafter, should have a reserve at least as great as the level premium 10-year term policy. Why would a company knowingly hold inadequate reserves? Because holding adequate reserves would require more capital, and the extra cost of capital will cause the company's rates to be noncompetitive. To stay competitive, the company cannot afford to hold higher reserves than its competitors' hold.

So what is the actual impact of these regulations? Of course it's too early to tell, but we can speculate. When Guideline XXX was passed, *The Wall Street Journal* article that Rachel mentioned described its view of the impact. The article was headlined, "Farewell to Level Insurance Premiums." Naturally, this caught my attention as I wondered how a product that had been around for more than 100 years would suddenly disappear. It said that the regulation "will probably trigger a 'last chance' marketing push for some low-cost life insurance."



## REINSURANCE RESPONSE TO GUIDELINE XXX AND REGULATION 147

The article went on to explain what it means by "low cost." It said, "Some consumers may indeed want to snap up today's guaranteed premium term policies. If held for the guarantee periods, these policies are typically the cheapest insurance coverage to be found." It "would require many insurance companies to set aside bigger reserves when they make such long-term rate promises." That's true, but it doesn't clarify the fact that bigger reserves are necessary to ensure company solvency so that those long-term promises can be kept.

So I have to ask here, why should a higher reserve requirement cause a product to disappear? Why does *The Wall Street Journal* article infer that level premium life will die because of heavier reserve requirements? And the answer, of course, is at the end of the article that Rachel pointed out. "Consumers want the guarantee, but it remains to be seen how much they are willing to pay for it." So now we're associating price with guarantees.

However, this is not just the fault of the consumer. I submit that we in the industry are partially at fault because we have convinced the consumer that guarantees do not have a price. Those of us over the age of 40 can recall when whole life insurance with level premiums was a very popular, if not the most popular, product. The consumer was willing to pay higher premiums at issue in return for the guarantee of fixed-cost life insurance for the rest of his or her life.

With participating whole life, the consumer could expect to receive dividends that would reduce or even eliminate the annual premium outlay. With nonparticipating products, the going-in rate was lower and it was guaranteed for life. Before universal life was introduced, nonparticipating indeterminate premium products were developed, which competed very effectively with participating whole life even in a high-interest environment. Either way, the consumer was pleased with his or her purchase and was willing to pay the price for the guarantee, which, of course, included reserves even higher than those on level premium term insurance.

Even *The Wall Street Journal* article does mention cash-value plans near the end of the article. However, they are mentioned in the context of term conversion privileges rather than being a viable alternative at original issue. It seems to me there's almost a conspiracy against long-term guarantees and insurance. Notably, *The Wall Street Journal* article does not point out the fact that a cash value policy purchased at a later attained age as a result of a term conversion would probably cost even more than the term rates offered the policyholder whose health is so bad he can't reenter—a situation that the article suggests should be avoided.

But I don't think even *The Wall Street Journal* article is necessarily saying that level premium term is the lowest-cost product. How could it be simultaneously cheaper than both cash value life and annually renewable term? No, I think *The Wall Street Journal* is saying that *today's* level term products are a bargain because they were underpriced relative to the new reserve requirements. So what we have now is like a fire sale or a going-out-of-business sale.

To some degree, the industry has gone along with this something-for-nothing philosophy in its sales techniques. The biggest insurance issues these days have to do with disclosure and deceptive sales practices, not pricing or valuation. We have all heard about agents who have tried to sell insurance without calling it insurance. Too often, we find that

policyholders do not understand what they have purchased or, worse still, they have purchased the wrong product because an agent talked them into it.

The difficulty of selling valuable products at an adequate price has an impact on valuation. One way of selling a long-term guarantee on a term product has been to hold less-than-adequate reserves, thus charging less for reserve strain. In fact, it seems evident that in promulgating Regulation 147, New York was concerned about inadequate rates as well as inadequate reserves. They are really one and the same thing. Given a set of guaranteed benefits, a decrease in the guaranteed premiums should cause a compensating increase in the reserves. Or, to use New York's own example, given a ten-year term policy with level guaranteed rates, an extension of the guaranteed rates into the future should not decrease the reserve needed and may, in fact, increase it.

Regulation 147 and Guideline XXX are solutions to this problem, but are they the correct solutions? Well, let's see, what do I do first? Pick a mortality table? Segment the policy? Calculate the basic reserve? Calculate the deficiency reserve? Will I use the same mortality table to segment the policy that I do to calculate the basic reserve? What about the mortality table for the deficiency reserve? Or, wait a minute. You say that the mortality table I use to segment the policy under Guideline XXX is different from the one that I use to segment the policy in New York. I'm really lost now.

These regulations are complicated, and I think they're too complicated. To add further insanity, why do we continue to have an artificial split between "basic" reserves and "deficiency" reserves? Is one more real than the other? I appreciate the fact that the IRS still sees a difference between the two, but I believe that for the sake of the industry, as well as for our own professional integrity, we should do all we can to discourage this notion rather than promote it. I do not accept the idea that we should pay taxes on income that is not available for dividends to shareholders or to policyholders, or for investment in new business.

The valuation methods described in the regulations are complex and cumbersome. A more elegant alternative, which I'd like to suggest, is called the "unified method," and it's described in a paper, "Statutory Reserves for Nonlevel Premium Policies," by A. Stephen Beach in the 1990 *Transactions of the Society of Actuaries* (Volume XLII). Mr. Beach's method is a modification of the method proposed by Paul Sarnoff in his discussion of Don Sondergeld's paper on the "Changing Premium Valuation Method," which appears in the 1978 *Transactions* (Volume XXX). I was an actuarial student working for Mr. Sarnoff at that time, and I assisted him in the analysis he did to prepare for this commentary. Therefore, I recommend these papers for your reading pleasure, and I would be happy to discuss them with anybody who is interested.

Why do we need formula reserves anyway, when we have to do cash-flow testing on virtually all our business in many states? Those of you who are valuation actuaries may have shared a unique experience I recently had. I just became appointed actuary this year. As you can probably tell, I have never been without opinions, but usually I promote only one opinion at a time. This year, because of New York's unique requirements, I was forced to put forth two actuarial opinions: my New York opinion and my real opinion. In the New York opinion, I pointed out that that was not my real opinion, but rather was a technical result of New York's unique requirements.

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Nevertheless, although the regulations are cumbersome, I believe they will essentially achieve their desired purpose of restoring reserve adequacy while, at the same time, increasing profits for several different software firms that are prepared to assist you with these calculations and for professional auditors who must spend more time reviewing them. Just like tax reserves, Regulation 147 reserves will be nearly unauditible.

How can reinsurers help? My company and other reinsurers are in the business of managing risk and the use of capital. Actually, these are very closely related activities, as "economic risk" can refer to how you employ your resources in general, including capital.

If we or any other reinsurer coinsure a piece of your business for which Regulation 147 or Guideline XXX requires higher reserves, we and our retrocessionaires will hold those reserves. However, because we deal with companies in many different states and even in other countries, we do have access to cheaper sources of capital, so our cost for holding the reserves may be less than yours, and we can pass these savings back to you.

Traditionally, reinsurers have helped companies enter into new ventures of all kinds, including newly designed products, by becoming a partner through quota share reinsurance arrangements. This applies equally well to the products affected by Regulation 147 and Guideline XXX. Moreover, because of our extensive experience with different types of clients and with various products, we can help you find a product design and reinsurance arrangement that is best for you.

Back to my friend at the party. Remember at the beginning of my speech? I was telling him what a reinsurance valuation actuary does. Now maybe I can explain it to him better. A reinsurance company helps its clients develop and sell products that are both marketable and profitable. As a valuation actuary, it is my job to make sure that both my company and its clients will be around to keep their promises.

MR. REALE: There are two sides to this issue for reinsurers. From a valuation point of view, a valuation actuary is looking at this thing and saying that it is a nightmare to handle the additional calculations.

From my point of view as a marketing actuary, as you've probably seen, there have been more reinsurance opportunities recently. There has been an increased activity in product development, which should lead to more quoting opportunities. And I think the reinsurer that can provide the additional reserve credits at a reasonable cost will have more of the focus in the future.

Also, what we've seen is direct involvement with product development, pricing specifically to coordinate with Regulation 147, and coupling it with a reinsurance program. I'm sure some other reinsurers have also seen that as well.

MR. MARVIN D. FINEMAN: The question I have comes down to the ROI discussion you had earlier. We're talking statutory accounting here. Many stock companies, which would include Equitable, I think, are pricing on a GAAP ROI basis or more on a GAAP basis. The problem would only arise if you had fairly thin statutory capital. Otherwise, it seems to me to be a nonproblem. If you try to buy some reinsurance to get yourself out of the statutory problem, then you're incurring an actual dollar excess cost. And if your

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GAAP reserves are already sufficient, then certainly you are going to have to raise premiums to pay for those excess reinsurance costs that you've incurred.

Would anybody like to talk a little bit about the relationship of GAAP and the statutory and the amount of surplus that companies that are selling term insurance have?

MS. HANCOCK: Certainly your point is valid about well-capitalized companies on a statutory basis. I think if a large term writer continues to write large amounts of term business with long guarantees, you're still going to have a fair amount of reserves or an allocation of surplus on a statutory basis. You still have to manage your statutory surplus needs even if you still have a statutory statement and statutory risk-based capital (RBC) standards to concern yourself with.

MR. CLAPPER: I would just say the value of statutory capital is really more of a market thing. It's not a matter of whether you have too much or too little. It's valuable whether you have too much or too little. So you ought to manage it carefully and consider the price of investing it in different enterprises even if you have a lot of it. And I think it has to be managed as a separate part of your pricing even if the GAAP results do look good. You can't ignore it. And we're a public company so we're GAAP, too.

FROM THE FLOOR: I have a question for Frank. What have you seen as far as the implementation of Regulation 147 and the effects on the in-force business? How have companies affected changes in reserves as a result of Regulation 147? Basically, has there been an increase or decrease in reserves as a result of parts of Regulation 147 on the in-force business, specifically, deficiency reserves?

MR. CLAPPER: Well, companies have mainly redesigned their new products so it wouldn't hit them too hard. I have heard that some New York companies, though, actually end up decreasing many reserves.

The incentive for New York to pass Regulation 147 in the first place was to even the playing field. It wasn't that New York domestics were holding adequate reserves, it's that New York domestics were holding higher reserves than anybody else was holding on the same product. So they were evened out so it could go either way. And, as we discussed, sometimes the unitary reserves are actually higher than the segmented reserves, which is strange, but it does happen.

MS. HANCOCK: I'd like to just make one comment on the reserve adequacy. I think it's true that many companies using the old unitary method probably were underreserved but, at the same time, I'm not sure that the increase in reserves under Guideline XXX is what was needed to make them adequate. There are still valuation regulations and tables that don't reflect preferred underwriting. And it's not as if you get a deficiency credit on the standard policies that offsets the deficiencies that you get on the preferred.

## REINSURANCE RESPONSE TO GUIDELINE XXX AND REGULATION 147

MR. JAMES R. SWAYZE\*: A few New York companies are represented here. What has been the trend thus far in product design? The Equitable dropped the guarantee, whereas I'm sure some other companies have raised their premium rates to compensate for that.

It would stand to reason, from my perspective, that because insurance is a product that is sold and not bought, if I were an agent, it would be a little bit easier to sell a longer guarantee which, in essence, would have a higher premium and probably need a higher commission, too. And I was wondering if there has been any general consensus.

MS. HANCOCK: I did a survey of about 20–25 New York–domiciled companies only, asking them how they were going to change, or what they thought they would do to their products in terms of design. Nearly all said that they would just go to a five-year guarantee. I don't think that's the same conclusion that non-New York companies are coming to.

MR. CLAPPER: Some companies are keeping both. That was even mentioned in *The Wall Street Journal* article. They're keeping a new product which shows less reserve strain, and then another product, which has higher reserve strain and a longer guarantee, and they're going to see which one the public wants.

FROM THE FLOOR: I've heard that several companies are tackling the problem by the eventuality of Guideline XXX coming into force, simply maintaining their rates as status quo and then offering a rider, which the policyholder can purchase to maintain the guarantee period. I had then also heard that a few states will not allow this rider to be offered, and Washington is one that comes to mind. I thought New Jersey was one as well. I wonder if anybody knows which states forbid that.

MR. CLAPPER: I heard it was an endorsement rather than a rider. The reason for that is so that they wouldn't have to change their policy form when the state passed Guideline XXX, and they didn't want to offer a guarantee anymore. I don't know if any states have disallowed it. I haven't heard about that.

FROM THE FLOOR: Guideline XXX is not going to help decrease your reserves. I think the issue was that Regulation 147 did help to decrease the reserves from Guideline IV. And the question I had was what's the current position of New York State with other companies regarding Guideline IV?

MR. CLAPPER: The reason Bob Callahan pushed Regulation 147 was because he thought Guideline IV applied to everything, and he found out at the NAIC level that it interpreted that it only applied to 58 CSO business. So apparently he's accepting the idea that it only applies to 58 CSO business, so we need 147 for 80 CSO business. That was one of the big reasons why he said it needed to be passed in the first place.

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\*Mr. Swayze, not a member of the sponsoring organizations, is Vice President of Intercedent Actuaries and Consultants in Toronto, Ontario, Canada.

