The Financial Reporter

February 2000 – Issue 41

COLIFR Corner

by Kevin Palmer

Editor's Note: COLIFR is the American Academy of Actuaries' Committee on Life Insurance Financial Reporting. COLIFR monitors activities related to life insurance and annuity financial reporting and is actively involved in many of these activities. The committee conducts analysis and makes recommendations regarding the actuarial aspects of financial reporting issues.

COLIFR met on June 11, 1999, in Chicago, on October 12, 1999, in New York City and on December 14, 1999, in Orlando. A meeting is scheduled for March 15, 2000, in Chicago. Dan Kunesh now chairs the committee, having assumed that role from Ed Robbins at the October meeting.

Valuation Task Force

The American Academy of Actuaries' Valuation Task Force (VTF) continues to work toward a Unified Valuation System (UVS). The framework currently envisioned would include:

- The use of S-curve analysis to determine a minimum level of assets required in support of reserves and risk-based capital
- Continued use of formula reserves for existing products, with S-curve analysis used to determine reserves for innovative products
- Preparation of a vitality/viability report examining resources needed to execute the company's business plan
- Discussion of low likelihood/high impact risk events

The VTF discussed its work with the NAIC Life and Health Actuarial Task Force (LHATF) at meetings in August and October. The LHATF is supportive of the direction the project is taking.

Topics currently being developed by the VTF include valuation of non-guaranteed elements and the appropriate role of a "reviewing actuary." The task force is also compiling a list of possible research projects for consideration by the Society of Actuaries or others. The task force may offer a one-day seminar on the Unified Valuation System (UVS) next fall. Dave Sandberg, a member of COLIFR, is now chairing the VTF.

Other LHATF Items

A revised Actuarial Opinion and Memorandum Regulation (AOMR) was exposed for comment. The revised AOMR would allow actuaries to file "state of domicile" in states enacting such provision. It would also require Section 7 companies to compare statement reserves to gross premium valuations.

There has been much recent discussion of issues related to GICs and other products with liquidity provisions that can be triggered in the event of a ratings downgrade. An Academy work group has been formed to consider statutory reserve requirements and liquidity and risk management practices.

Actuarial Guideline ZZZZ, which discusses reserving for Equity Indexed Universal Life products, was adopted by the LHATF in June but will not be made effective for 1999. The guideline currently describes two types of computational methods and requires quarterly actuarial certifications. The LHATF Innovative Products Working Group may continue to consider other computational methods.

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An Academy work group has drafted an actuarial guideline to clarify statutory reserve requirements for Guaranteed Minimum Death Benefits offered with variable life insurance products. The method recommended would require reserves equal to the greater of 1) one-year term reserves assuming an immediate one-third drop in account values, and 2) attained-age level reserves covering the entire guarantee period and assuming no immediate drop in account values.

The Academy's Variable Annuities with Guaranteed Living Benefits (VAGLB) Working Group continues to look at possible reserving methodologies. The group has developed a single scenario, Guideline 34-like approach called the "Keel Method." The Keel Method appears to produce appropriate reserves for "roll-up" benefit designs, but not for "ratchet" designs where benefits are path-dependent.

Risk Based Capital (RBC)

The C-3 Subgroup of the AAA Life RBC Task Force presented a proposal at the October NAIC meeting. The NAIC RBC Working Group agreed to expose the proposal for comment, with a vote at the December meeting. If adopted, the method of calculating the C-3 component would change effective for December 31, 2000.

For a company filing a Section 8 opinion, the C-3 requirement related to cash flow tested fixed annuity and single pay life products would be calculated based on the same cash flow testing model used to support the actuarial opinion, but run over different interest scenarios. A method of measuring results has been designed to approximate the 95th percentile C-3 risk. A company could test over 50 annually prescribed interest scenarios, or over a more conservative 12-scenario set. Testing could be done as of a date other than 12/31, with the ratio of required C-3 to tested reserves at the "as-of" date then applied to 12/31 reserves. The Appointed Actuary would need to certify that assumptions used are not unreasonable for the products, scenarios and regulatory purpose being tested.

The C-3 amount required for tested annuity and single pay life products would be added to formula amounts required for all other products and for callable assets supporting untested products or surplus. The overall C-3 RBC component would be limited to between half and twice the amount that would be calculated based on current factors and instructions. Testing indicates C-3 RBC would be less than the current formula amount if interest rate risk is reasonably well managed.

GAAP Developments

The FASB exposure draft *Proposed Statement of Financial Accounting Concepts: Using Cash Flow Information and Present Value in Accounting Measurements* was published on March 31. The FASB has indicated the guidance in this document would be used in estimating the fair value of insurance liabilities. COLIFR submitted a comment letter, expressing concern about the application of certain concepts to the valuation of insurance liabilities. One such concept is that the value placed on insurance liabilities should reflect the insurance company's credit rating. COLIFR will continue to engage in discussions of this important and controversial topic.

The AICPA is drafting a Statement of Position (SOP) on accounting for demutualizations and formations of mutual holding companies. The target is to make the SOP effective for fiscal years beginning after December 15, 2000. The current version would require presentation of closed block assets, liabilities and operating results on a fully consolidated basis rather than as single line items. Participating contracts would be accounted for under SOP 95-1, except a company that demutualized prior to the effective date of SFAS 120 and elected not to adopt SFAS 120, could continue to apply SFAS 60. In a departure from SOP 95-1, however, the draft SOP would apply the provisions of paragraph 42 of SFAS 60. This requires the establishment of a dividend liability so amounts accruing to policyholders are not reported with shareholders' equity.

An AICPA Discussion Paper on "Accounting by Life Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Covered by FASB Statement No. 97" was published on June 25, 1999. COLIFR submitted comments on this paper, taking the position that additional accounting guidance is needed in this area to promote consistency of practice. COLIFR suggested it may be appropriate to continue deferral of costs associated with a replacement policy when there is evidence the replacement is a continuation of the prior contractual relationship.

COLIFR intends to develop a set of GAAP Practice Notes. A GAAP practice survey has been prepared and will be distributed soon to company chief actuaries.

Professional Development

The Academy is reviewing Qualification Standards in light of the new SOA education system. General Qualification Standards appear to be covered, but it is thought the Academy may need to develop a new exam to maintain the Specific Qualification Standards required to sign an Annual Statement opinion. Current thinking is this could be an open-book exam following a 3-day seminar, and completion of the course would fit within the formal program component of the SOA Professional Development Requirement.

COLIFR will continue to follow these topics and others involving financial reporting. Progress will be reported in future issues of *The Financial Reporter*.

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Passing of the gavel at October Council meeting

Financial Reporting Section Chairperson Mike McLaughlin presents a gavel to outgoing chairperson Shirley Shao as a token of the Section's appreciation, with retiring treasurer Ed Robbins looking on.