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COLIFR Corner

by Harold Forbes

Editor's Note: This is the sixth installment of "COLIFR Corner." The American Academy of Actuaries' Committee on Life Insurance Financial Reporting (COLIFR) monitors various financial reporting topics of interest to actuaries and is actively involved in several. There have been three meetings since the last installment of COLIFR Corner. The most recent meeting was on March 9 at the Academy offices in Washington. The next meeting will be on June 11 in Chicago.

Model Regulation XXX

One of the most significant events since the last report was the rapid revision and passage by the NAIC of a revised XXX Model Regulation. Armand de Palo of The Guardian and Steve Smith of First Colony have been instrumental in moving the revised regulation along and building an industry consensus in support of it. The motivation to adopt the regulation is to reduce marketplace turmoil and provide a more level playing field between companies that operate within states that have adopted the current XXX Regulation and those that have not. Key states indicated that they were willing to support the revisions and it is felt that other states would follow. The revised regulation includes formula based "humpback" reserves based on expected premium patterns, revised mortality levels, and a smoker/nonsmoker distinction. Care was taken during the development so as not to produce a new prevailing mortality table for tax purposes.

Valuation Task Force

The Academy's Valuation Task Force released its report to LHATF on a Unified Valuation System on December 5, 1998. Work continues in a number of subgroups. In particular, the numerical examples subgroup is working to create a model to demonstrate the before and after impacts on a company of a Unified Valuation System (UVS). Regulators have a number of concerns including compatibility of the UVS with existing state laws, assuring "consistency" among companies in their valuation practices, and the ability to "produce auditable and verifiable results," among others. Regulators want an early warning on impending problems. The current approach, which allows for the verification of formulas, doesn't provide for trend analysis.

Other LHATF Items

A new CSO mortality table is under consideration. Preliminary decisions are that the new table layout will be similar to the current tables—Male/Female and Smoker/Non-smoker. There will not be an increase in the number of tables. The actuary will still have to deal with superselect underwriting classes.

The Actuarial Opinion and Memorandum Regulation is still under consideration. Contentious areas relate to the "this state" part of the rewrite. One proposal, in order to do a state of domicile opinion, includes asset adequacy testing, disclosure of codification, and prior approval of the Commissioner in the state of filing.

Risk Based Capital (RBC)

The C3 subgroup of the NAIC's Life RBC Committee has been working to improve on the C-3 risk component. A method that develops the C-3 risk as an offshoot to cash flow testing is being tested. Six companies are participating in the testing. The number of interest rate scenarios has been narrowed down from 200 to 50. Items still under consideration are a reduced number of scenarios to be used, in conjunction with a more conservative answer, if a company didn't want to run 50 scenarios, rules on aggregation, new business, volatility, and less onerous tests for liability type products.

Annuity Developments

The NAIC passed Guideline ZZZ at its December meeting along with a model regulation on separate account funding for minimum benefits under group contracts (synthetic GICs). The exposure period for Guideline ZZZZ (Equity indexed universal life) was extended to May 15.

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Work continues in the Variable Annuity with Guaranteed Living Death Benefits (VAGLB) Working Group. A major task is to develop a proposed CARVM reserving methodology. The working group has also been asked to propose an interim RBC C-3 factor for use at 1999 year end. Expected costs for VAGLBs generally have a catastrophic type distribution—mostly zero but with very large potential amounts at the extremes. Initial thinking is to use an

(continued on page 20, column 1)

COLIFR Corner
continued from page 19

approach for VAGLBs that is similar to that used for GMDBs, possibly using a "keel" method which essentially projects the expected fund value at the bottom 85th percentile value period-by-period. One possibility for determining the C-3 factor is to use a similar approach, but with a 95th rather than an 85th percentile.

Life Practice Notes

Life Practice Notes on equity indexed annuities, variable annuities, life illustrations, and three on demutualization have been approved. Other practice notes are in development for XXX and reinsurance. It is expected that these practice notes, along with updated current practice notes, will be available in the future at the Academy's web site (*www.actuary.org*).

GAAP Developments

The AICPA task force on non-traditional long-duration contracts is in the process of developing a proposed Statement of Position that will provide guidance on the GAAP accounting, reporting and disclosure for many of the innovative insurance products that have hit the market in recent years. Currently there is divergent treatment within the industry. The focus is currently on interpreting existing standards. Many existing products were not around when the standards were developed, or are offered through a separate account but contain guarantees.

Highlighted products or product features include variable annuities with minimum guaranteed death benefits of guaranteed living benefits, equity indexed products (life and annuity), bonus interest rates, persistency interest rates, modified guaranteed life and annuity products (products with market value adjustments), and synthetic GICs.

A subgroup of the Committee continues to track developments with the International Accounting Standards Committee'. Current activity relates to the IASCs efforts to develop a set of global standards for cross-border security filings, including business combinations. A G4+1 position paper describes the purchase and pooling methods of accounting for business combinations, and introduces a third possible method, the fresh start method for special cases. The G4+1 clearly favors the purchase method. This approach appears to be more consistent with the general desire to move toward fair value reporting by the IASC, the FASB, and the SEC.

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Demutualization

The AIPCA anticipates issuing guidance in 1999 for mutual company reorganizations, including demutualizations and mutual holding companies.

The Committee will continue to follow these and other developments involving financial reporting as they develop. Progress will continue to be reported in future issues of *The Financial Reporter.*

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"X" Factor
continued from page 17

by a factor of 100. I used the Monte Carlo method with 200 trials. The means of the populations are the same but the tail of the each distribution is different. This is reflected in the ratio of the 99% quantile to the 50% quantile.

Concluding Remarks

While this article discusses two approaches to justifying the choice of the "X" factor, other equally valid approaches undoubtedly exist. If further research is done on this topic, the following issues should be considered:

1. If exposures are measured by units of inforce such as, per $1000 of insurance, how should the standard deviation of the mortality rates be calculated?
2. Can Monte Carlo studies be based on units of exposure other than lives?
3. Can the existence of reinsurance and/or the level of reinsurance costs and mortality charges be used to justify the choice of an "X" factor?
4. Should an Actuarial Standard of Practice be developed to address this topic?

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