Update On Regulatory Developments

By Francis de Regnaucourt

This is a quarterly update on developments at the National Association of Insurance Commissioners (NAIC), the International Association of Insurance Supervisors (IAIS), as well as other groups who may get involved in group supervision, with emphasis on those that may be important to members of the Financial Reporting Section.

In March 2014, New York Department of Financial Services (NYDFS) announced its intention to update reserving formulas for term business issued after Jan. 1, 2015, greatly simplifying the current XXX process and reducing reserves significantly based on empirical evidence of mortality improvement.

In June 2014, the Senate passed a bill to clarify the "Collins Amendment" and allow the Federal Reserve to apply insurance-specific capital standards to the insurance portion of groups they supervise.

The NAIC does not have an in-person meeting during the second quarter, but the Life Actuarial Task Force (LATF) and its working groups continue to push many initiatives forward. We report below on a few items that may be of interest to members.

On the international side, the IAIS has started work on its basic capital requirements (BCR) formula. The formula structure has been exposed, and the development of the specific risk coefficients is to be completed by the end of 2014. Capital standards are extremely important to the insurance industry, and there have been several comments that the process needs to be made more transparent well before the standards are finalized.

NEW YORK REVISIONS OF XXX (AND POSSIBLY AXXX) RESERVES

On March 27, 2014, New York's Superintendent of the Department of Financial Services issued a letter to other insurance commissioners setting out the department's intention to overhaul XXX (and eventually AXXX) reserves.

For term life policies issued after Jan. 1, 2015, they will propose regulation changes to allow:

- Annual mortality improvement adjustments to the 2001 CSO table of 1 percent for years 2008-2047 and 0.5 percent thereafter, during the initial level term period only;
- A two-year full preliminary term formula to reflect the higher up-front expenses of issuing term business.

The department said that the XXX methods produced reserves that were high in relation to emerging actuarial experience, and that the new proposed method should reduce reserves by 30 to 35 percent. They plan to address AXXX reserves for universal life with secondary guarantees next.

This is a radical departure from the department's past position. New York is also taking a different direction from the principle-based reserves approach adopted by the NAIC, but for the time being, the NAIC's Principles Based Reserving Task Force is continuing its work as before. As of this writing, we know of no discussions taking place to reconcile the two approaches, but we will continue to report on developments.

FEDERAL REGULATION: CLARIFICATION OF THE "COLLINS AMENDMENT"

On June 3, 2014, the Senate passed S. 2270, "the Insurance Capital Standards Clarification Act of 2014," to clarify Section 171 to the Dodd-Frank Act (the "Collins Amendment"). This amendment, introduced in 2010 by Senator Susan Collins (R-Maine), was meant to hold insurers deemed "too big to fail" (known as Systemically Important Financial Institutions or SIFIs) to capital standards at least as high as those required for community banks.

"At least as high" does not mean that the expectations are the same for all institutions. The Federal Reserve has "tailored expectations for BHCs[1] of different sizes, scope of operations, activities, and systemic importance in various aspects of capital planning,"[2] showing its willingness to customize its regulatory analysis to the unique circumstances of individual institutions. Its lawyers, however, were concerned that the Collins Amendment could be interpreted to require the same capital rules for SIFIs as for banks, in effect taking away the Fed's flexibility.

Francis de Regnaucourt, FSA, CERA, FCIA, MAAA, is a director at KPMG. He can be reached at fderegnaucourt@kpmg.com.

CONTINUED ON PAGE 14

In a March 2014 statement, Senator Collins clarified that her intentions were not to "supplant prudential state-based insurance regulation with a bank-centric capital regime for insurance activities," and sponsored Bill S. 2270, to allow the Fed to apply insurance-based capital standards to the insurance portion of the business, while still keeping banking capital standards for the banking portion of the business.

Most observers expect the companion House bill (H.R. 4510) to get support in the House Financial Services Committee, and to be passed as well. This should allow the Fed to set capital standards better tailored to the insurance operations of SIFIs.

NAIC DEVELOPMENTS

The American Academy of Actuaries (AAA) Life Experience Subcommittee is continuing work on a proposed 2014 VBT mortality table with a view toward a proposal at the NAIC's summer meeting in August. The current work focuses on (a) the slope of the mortality curve at older ages, and (b) margins to be included for confidence levels, variations among companies, random fluctuations and unknown fluctuations.

LATF is working on a number of technical changes to VM-20 with the help of the AAA's Life Reserving Working Group: treatment of due and deferred premiums, and the small company exemption among them.

LATF also has a working group on non-forfeiture values for guaranteed living benefits. The idea is that the policyholder pays a premium for a significant option and should get a refund of the unused part of that option if they surrender the contract.

IAIS BASIC CAPITAL REQUIREMENTS (BCR)

The IAIS held an observers' session on BCR on March 14, 2014, ahead of its field testing with insurers who are likely to be designated Internationally Active Insurance Groups (IAIG). The current plan[3] is to set BCR based on exposures to six categories of activity:

- Traditional life insurance (risk-weighted liabilities),
- Traditional non-life insurance (risk-weighted liabilities),
- Assets (risk-weighted assets),
- Asset-liability matching (indicator to reflect mismatch),
- Non-traditional insurance (other indicator or estimate), and
- Non-insurance (measure based on the non-insurance sector, e.g., Basel requirements for banks).

$$BCR = \alpha\ \{\beta_1\ (\text{Trad Life}) + \beta_2\ (\text{Trad Non-Life}) + \beta_3\ (\text{Assets}) + \beta_4\ (\text{ALM}) + \beta_5\ (\text{Non-Trad Ins})\} + \gamma\ (\text{Non-Ins})$$

The current BCR proposal is to multiply each of the indicators of activity by coefficients calibrated to reflect relative riskiness, and the overall level of confidence. Coefficients are to be developed in the field testing exercise.

Dr. Yoshihiro Kawai, the secretary-general of the IAIS, spoke on this topic at the NAIC's International Insurance Forum in May 2014. He reported that the IAIS intended to complete the BCR formula and make it public by the end of 2014. Several attendees at the conference expressed concern about their perceived lack of openness around the process for setting the coefficients in the formula. Connecticut Governor Dannel Malloy, in a keynote address the previous day, had also commented that capital rules needed to be developed in a way that was acceptable to the industry and to the United States. This writer agrees. Capital standards are crucial to the industry, and the process of defining them would benefit from open discussion and participation by all parties, including those subject to them. Dr. Kawai was very graceful in his remarks, and we expect he will respond equally gracefully to the concerns voiced at the forum. ■

ENDNOTES

[1] *Bank holding companies.*

[2] *Source: Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice, U.S. Federal Reserve, August 2013.*

[3] *The entire presentation is available at www.iaisweb.org/view/element_href.cfm?src=1/21698.pdf.*