

PBA Corner

By Karen Rudolph

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UPDATE ON STATE ADOPTION STATUS OF PRINCIPLE-BASED RESERVES

Fifteen states adopted the complement of principle-based reserve (PBR) legislation in either 2013 or 2014. These states include Arizona, Indiana, Iowa, Louisiana, Maine, Mississippi, Nebraska, New Hampshire, New Mexico, Ohio, Oklahoma, Rhode Island, Tennessee, Virginia and West Virginia. Total premium contributed by these 15 states, based on 2008 annual statement data, is 19 percent. Three state legislatures have advanced the PBR package to the governor and await signatures, including Connecticut, Florida and Hawaii. These states are expected to have the adoption in place for 2014, providing an additional 9 percent of premium for a total count of 18 states and 28 percent of industry premium. This implies a gap of 24 states and 47 percent of premium in achieving an operative date for the Valuation Manual. There are states in which the PBR package is in various earlier stages of introduction. These include Georgia, Illinois, Missouri, Texas and Washington.

NEW YORK PROPOSED AMENDMENTS TO REGULATIONS 147 AND 179

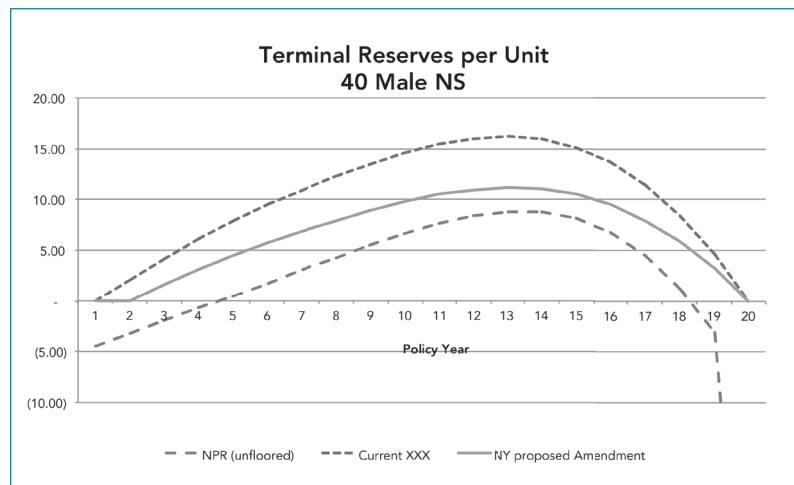
On April 30, 2014, the New York Department of Financial Services (NYDFS) proposed changes to its term reserving requirements by issuing proposed changes to Regulation 147 (Valuation of Life Insurance Reserves) and Regulation 179, which recognizes and permits use of the 2001 CSO Mortality Table and corresponding preferred mortality tables. This proposal follows the March 27, 2014 N.Y. Superintendent's letter to insurance commissioners that "... our term life formula results in reserves that are high relative to actuarial experience and should be modernized." The proposed changes to N.Y. regulations include two critical elements applicable only to varying premium term life insurance policies¹: (i) allowance of a prescribed

level of mortality improvement in the first segment and (ii) introduction of an alternative segment method which, together with the unitary method,² is to be used as the basic reserve for varying premium term life insurance policies issued on or after Jan. 1, 2015. The alternative segment method is equivalent to a two-year preliminary term methodology during the first segment. The recognition of mortality improvement provides the majority of reserve relief from current Triple-X minimum reserves. The chart below uses the single-cell 20-Year Level Term policy from the December 2013 *Financial Reporter* PBR Corner article and overlays this demonstration with the NYDFS proposed amendment reserve for a policy issued in 2015. The NYDFS March 27, 2014 letter included a similar chart and suggested the reserve reduction would be 30 to 35 percent on a prospective basis. Both charts support this claim.

It is not surprising to see the N.Y. proposed reserve comes in higher than the PBR floor reserve (i.e., the net premium reserve (NPR)) given New York's continued opposition to components of PBR in general. The comment period for these proposals ended on June 16, 2014. NYDFS has also indicated it continues with efforts to modernize its reserve standards for universal life with secondary guarantee (ULSG) products. This is a direct result of New York's rejection of the Actuarial



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Guideline 38 compromise, advanced by the National Association of Insurance Commissioners (NAIC) last September. This initiative will be more difficult, obviously, given the flexible nature of ULSG policies.

The Life Insurance Council of New York, Inc. (LICONY), which is an industry group for N.Y. companies, issued a response letter to NYDFS on June 13, 2014. In the letter, LICONY applauds NYDFS for acknowledging the conservatism in today's term life insurance reserves, but goes on to point out critical items that may preclude companies from benefiting from the NYDFS proposal.

– The scope of the proposal will benefit life insurers domiciled in New York that write business only in New York. Companies domiciled in New York and writing business in New York and other states will still need to meet the minimum reserve requirements of the other states, and no other state is contemplating changes similar to NYDFS' proposal.

– It is unclear to LICONY whether NYDFS intends to allow the recognition of mortality improvement in the deficiency reserve calculation as well as the basic reserve calculation. The proposed amendments appear to revise only the section of New York's regulations that pertain to basic reserves. If the mortality improvement is disallowed for deficiency reserves, LICONY points out that little reserve relief will occur should the deficiency reserve level remain unchanged.

– Another critical observation pertains to New York's Special Considerations Letter (published Oct. 31, 2013).

In the context of aggregate life insurance reserves, LICONY points out that the onerous requirements of the Special Considerations Letter work to dictate an aggregate reserve floor that may be unaffected by the NYDFS term reserve proposal. Specifically: (i) disallowing mortality improvement beyond the valuation date of the analysis, (ii) the requirement to "pass" all the N.Y. seven interest rate scenarios; (iii) the 125-basis-point net yield pick-up test, (iv) disallowing recognition of tail profits for level premium term insurance in the analysis, and (v) capping the lapse rate for ULSG policies at 1 percent for durations 11 and later without regard to actual company experience.

AMERICAN COUNCIL OF LIFE INSURERS (ACLI) SMALL COMPANY EXEMPTION AND OTHER PROPOSALS

ACLI and its member companies advanced several proposals to the Life Actuarial Task Force (LATF) of the NAIC. One proposal outlines criteria for exemption from the modeled components (deterministic reserve; stochastic reserve) of VM-20. At the time of this article, LATF was considering ACLI's proposals and requesting demonstrations to facilitate discussion. A summary of the proposals follows. As of this article, regulators have taken no action on these items.

1. Small Company Exemption. The objective of this proposal is to proportion the work imposed by VM-20 to the size and risk of the company. Currently, VM-20 allows exemption by product based on the risk profile of the product through use of the stochastic exclu-



sion test and deterministic exclusion test. ACLI suggests these tests represent a material amount of work for some companies and the proposal would permit companies meeting certain criteria to forgo the work involved in these exclusion tests and continue to apply the minimum reserve standards of VM-A and VM-C. The criteria include:

- a. Company has less than \$300 million of ordinary life premium and, if the company is a member of an NAIC group of life insurers, the group has combined ordinary life premiums of less than \$600 million, and
- b. The company reported total adjusted capital of at least 450 percent of the authorized control level risk-based capital (RBC) in the most recent RBC report, and the appointed actuary has provided an unqualified opinion on the reserves, and
- c. Any ULSG policies issued or assumed by the company after the operative date of the Valuation Manual meet the definition of a non-material secondary guarantee ULSG product.

In the case of a company meeting the criteria, minimum reserves for the non-material ULSG policies would be the VM-20 Section 3 NPR (for basic reserves) and VM-A, VM-C reserves for the alternative minimum (or deficiency) reserves; and such policies would not be deemed to automatically fail the deterministic exclusion test.

It is notable that the state of Oklahoma included a similar exemption in its adopted legislation (SB2045). In the Oklahoma law, the premium thresholds are \$300 million/\$1 billion; the RBC threshold is 450 percent; and the actuarial opinion must be unqualified. There is no non-material ULSG criterion. No other state has included such a provision in its adopted version. The domestic industry in Oklahoma pressed its regulators for this provision and it was supported by the commissioner. Should the ACLI's provision or another company exemption provision be included in the Valuation Manual, it is likely the Oklahoma version will be modified to be consistent with the NAIC version.

2. Non-Material Secondary Guarantee. This proposal is necessary given item "c" in the Small Company Exemption proposal described in item 1 above. ACLI suggests there are universal life products with notional,

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or non-material, secondary guarantee provisions. Such provisions allow the contract to remain in force primarily through the surrender charge period by specifying the cumulative premium total or shadow account balance necessary to remain in force for 15 or 20 years, for example. The definition includes a 20-year limit on the secondary guarantee period, grading down by 2/3 year for each issue age higher than 60; and a comparative test on required minimum premiums over the secondary guarantee period.

3. Modifications to the Stochastic Exclusion Ratio Test (SERT). Allows use of gross premium reserves determined from the company's asset adequacy testing models in lieu of the modified deterministic reserve amounts currently required by VM-20 for the SERT. In this case, the company may use the assumptions in the asset adequacy testing model as the anticipated experience assumptions required by SERT. The ACLI suggests that the original concept of SERT was based on the asset adequacy testing models and assumptions in order to facilitate ease in calculation. The proposal also increases the 4.5 percent SERT threshold to 6.0 percent, to accommodate volatility in this statistic in the early years of implementation of PBR as well as to mitigate false negative results. A false negative in the NAIC Impact Study was defined as a "failure" of the SERT, while the calculated stochastic reserve was not the greatest component of the PBR comparison. ■

ENDNOTES

¹ Varying premium term life insurance means a policy with an initial premium rate guaranteed for up to 30 years ending at or before age 80, followed by increasing varying premiums thereafter.

² Minimum reserve is greater of alternative segment method and unitary method.