



SOCIETY OF ACTUARIES

Article from:

# Financial Reporting

June 2015 – Issue 101

# Update on Regulatory Development

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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.

The Life Actuarial Task Force (LATF) met at the NAIC Spring Meeting in March. I report below on a few items that may be of interest to members of the section.

In March, the Federal Reserve reported on the results of the 2015 Comprehensive Capital Analysis and Review (CCAR) for the 31 largest banks. The Board objected to two of the banks' plans, did not object to 28 of them, and conditionally did not object to the last one. It is expected that the Fed will also require CCAR from non-bank Systemically Important Financial Institutions (SIFIs) once it defines a capital framework for them.

On the international side, the IAIS published the compiled non-confidential responses to its Consultation Document on Insurance Capital Standards (ICS) for Internationally Active Insurance Groups (IAIG) that were due in mid-February.

## LATF MEETING AT THE NAIC FALL MEETING, PHOENIX, MARCH 26 AND 27, 2015

I report here only the highlights of the meeting; complete details are in the minutes produced by the NAIC and available on their website. There was forward progress on many ongoing projects, but without notable landmarks; I do not report on those.

## NEW VALUATION MORTALITY TABLE

Mary Bahna-Nolan (AAA Life Experience Subcommittee) presented developments on the 2014 VBT and the accompanying CSO table. Risk rating tables are now complete; there will still be 10 tables (in order to not require system changes), but the proposed structure is being changed. The lowest is now the RR50 table (previously RR70). The tables are currently being exposed by LATF for adoption.

Proposed margins for the draft CSO 2017 table are about 18 percent in aggregate. This is lower than in the past because there is more data than in the past (439 percent additional exposures by face, 52 percent by number of policies), resulting in greater statistical significance of the data. No explicit margins are proposed for catastrophes, or random variations; the idea is that those events are covered by capital, not reserves. The CSO table will be exposed once the impact study (on cash values and statutory and tax reserves) is complete.

There remains an open question of having different margins by rating class, to reflect the different statistical credibility of the different classes, but several regulators questioned this approach.

## VM-22 WORKING GROUP

The Working Group took a step back this quarter to re-evaluate its approach. The scope of VM-22 (non-variable annuities) includes a broad variety of annuity products:

- Deferred Annuities, Deposit Funds
- Immediate Annuities, Structured Settlements
- Two-tiered Annuities
- Deposit Funds
- GICs, Stable Value
- Longevity Insurance
- Indexed Annuities
- Guaranteed Living Benefits on Annuity Products
- Contingent Deferred Annuities
- Modified Guaranteed Annuities

The table below summarizes the three possible approaches considered by the Working Group, and the advantages and disadvantages identified to date:

| Proposed Method                | Specifics   | Advantages  | Disadvantages   |
|--------------------------------|---|---|---|
| Replicate VM-20                | <ul style="list-style-type: none"> <li>• Include formulaic floor, similar to AG 33</li> <li>• Develop stochastic exclusion test for non-variable annuities</li> <li>• Stochastic reserve assumptions parallel VM-20, use economic scenario generator, and set reserve at CTE70</li> </ul> | <ul style="list-style-type: none"> <li>• Internal consistency</li> <li>• Most flexible with respect to new features</li> </ul>          | <ul style="list-style-type: none"> <li>• Greatest complexity</li> <li>• Heavy work burden for small companies</li> </ul>                  |
| Representative Scenario Method | <ul style="list-style-type: none"> <li>• Use a small number of representative, deterministic scenarios to approximate stochastic results</li> <li>• Base scenario, plus four alternative scenarios (+1, -1, +3, and -3 standard deviations) for each key product risk driver</li> </ul>   | <ul style="list-style-type: none"> <li>• Simplifies stochastic calculations</li> <li>• Readily adaptable to product features</li> </ul> | <ul style="list-style-type: none"> <li>• Needs validation</li> </ul>  |
| Modernized Formulas            | <ul style="list-style-type: none"> <li>• Keep current SVL framework</li> <li>• Propose fixes to "right-size" reserves</li> </ul>  | <ul style="list-style-type: none"> <li>• Pragmatic</li> <li>• Reduces work burden</li> </ul>  | <ul style="list-style-type: none"> <li>• Needs product by product assessment</li> <li>• New products may require special study</li> </ul> |

## CONTINGENT DEFERRED ANNUITY (CDA) SUBGROUP

This subgroup has three charges:

- Exempting CDAs from nonforfeiture regulations;
- Clarification and consistency with Stable Value requirements;<sup>1</sup> and
- Proposing revisions to AG43 for CDAs.

Bernie Birnbaum (Center for Economic Justice) opined that the first charge was controversial. Much of the discussion was focused on proposed wording for AG43 amendments to cover CDA valuation.

## IUL ILLUSTRATIONS

IUL illustrations remain a hot topic, and there was a 90-minute discussion of a draft Model IUL Illustration Regulation presented by Fred Andersen (Minn). A delegation of industry representatives and the Academy, as well as Bernie Birnbaum, participated in the discussion. A new draft is expected shortly for exposure as a result. Mike Cebula (N.Y.) stated that New York was working on amendments to its own Regulation 74, and voted against exposure of the new draft.

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## AGGREGATE MARGINS

Mark Birdsall (Kan.) and Steve Strommen made a presentation on aggregate margins for VM-20. They argued that stacking individual margins for different risks may not be appropriate, as it can: (a) be overly conservative, and (b) ignore correlations between individual risks. Implicit margins may further obscure the measurement of conservatism. They propose a total aggregate margin around a true central estimate in order to better measure conservatism and create more consistency around product types based on risk.<sup>2</sup>

## 2015 CCAR RESULTS FOR BANKS

On March 11, 2015, the Federal Reserve published the results of the 2015 CCAR results for the 31 largest Bank Holding Companies (BHC).<sup>3</sup> Based on the results of the review, BHCs may proceed with their capital plans if the Fed does not object. Objection may occur on quantitative grounds—if the CCAR shows capital levels falling below required levels in one of the scenarios; or qualitative grounds—if the Fed does not believe the BHC's capital models are robust enough to support a conclusion.

This year, it objected to only two plans, both on qualitative grounds. In a few instances, BHCs adjusted their capital plans before obtaining non-objection. In another instance, the Fed did not object to the capital plan, but is requiring the BHC to submit a new capital plan to address weaknesses in its capital planning process.

These 31 banks represent more than 80 percent of assets held by domestic BHCs. CCAR is in its fifth year, and the Fed commented that average capitalization ratios increased from 5.5 percent to 12.5 percent since 2009, the first year of CCAR.

## IAIS CONSULTATION DOCUMENT ON ICS

On March 6, 2015, the IAIS published a compilation of responses to its Consultation Document on International Capital Standards (ICS)<sup>4</sup> (confidential comments excluded). There were 55 respondents including actuarial associations and industry associations from several countries, regulators, audit firms, industry consultants, the U.S. Chamber of Commerce, the Central Bank of the Russian Federation, and a number of insurance groups:

- ACE Group
- Aegon NV
- Aflac
- AIA Group
- American International Group, Inc.
- Cathay Life Insurance Company
- Cincinnati Insurance Company
- CNA
- Genworth
- Liberty Mutual Insurance Group
- MassMutual Financial Group
- New York Life
- Northwestern Mutual Life
- Prudential Financial, Inc.
- Swiss Reinsurance Company
- Transatlantic Reinsurance Company
- Zurich Insurance Group

Readers are warned that the summary of responses has more than 1,300 pages. That said, the responses should form the foundation of the next version of ICS. ■

### ENDNOTE

- <sup>1</sup> CDAs and Stable Value products have this in common: both can have benefits tied to the value of a block of assets not on the insurer's books.
- <sup>2</sup> The results of a study sponsored by the Kansas Insurance Department can be obtained from Steve Strommen at [stevestrommen@blufftop.com](mailto:stevestrommen@blufftop.com).
- <sup>3</sup> Press release available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20150311a.htm>
- <sup>4</sup> Responses available at: <http://iaisweb.org/index.cfm?event=getPage&nodeId=25229>