

**1995 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS**

SESSION 1

Introduction and Overview

Steven A. Smith

Frank P. Dino

Donna R. Claire

Lauren M. Bloom

**1995 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS**

INTRODUCTION AND OVERVIEW

MR. STEVEN A. SMITH: With the exception of the presentation by Lauren Bloom, most of the material that we will cover is really "hot-off-the-press" updates from the NAIC and the Life & Health Actuarial Task Force. Much of the material that Donna will talk about is also very current.

Our first speaker is Frank Dino, chief actuary for the State of Colorado Division of Insurance. He is chair of the NAIC's Life & Health Actuarial Task Force, which just met last week. Frank is responsible for licensing of insurers in Colorado, the actuarial portion of examinations in that state, and analysis of actuarial memorandums. He's also significantly involved in all areas of reinsurance and in monitoring the companies' reinsurance activities and compliance.

Our second speaker is Donna Claire, who is the president of Claire Thinking, Inc. She engages in general insurance consulting with a focus on asset and liability management, corporate modeling, and valuation issues. She has chaired several industry advisory groups related to the valuation actuary concept, including the AAA Committee on Life Insurance Financial Reporting, responsible for the Life Practice Notes. She is a member of the Board of Governors of the Society of Actuaries (SOA) and of the American Academy of Actuaries (AAA) Life Practice Council. She is currently chairing the Society Task Force on Life Nonforfeiture. She has authored or coauthored several papers on cash-flow testing, dynamic solvency testing and valuation issues.

Our final speaker is Lauren Bloom, who is the general counsel for the AAA. She began her legal career as a trial attorney with the civil division of the U.S. Department of Justice under the Attorney General Honors Program and then spent four years in private practice before joining the Academy staff. Her litigation experience focused on the application of standards and due process, within the context of an accreditation system and on employment discrimination issues. She will be discussing the Actuarial Board for Counseling and Discipline (ABCD).

1995 VALUATION ACTUARY SYMPOSIUM

MR. FRANK P. DINO: The Life & Health Actuarial Task Force (LHATF) of the NAIC has had a charge to research and develop a new life nonforfeiture law. This project has been going on for a number of years. At the December 1994 meeting of the LHATF, a decision was made to reconsider the current efforts and consider a fresh start, relying upon basic actuarial principals to develop nonforfeiture values. The task force requested the assistance of the SOA and the AAA in this effort.

The task force made a number of significant preliminary decisions regarding what should be part of the basis for the new nonforfeiture law:

1. Regulate at the least restrictive level necessary to obtain the desired results,
2. Persisting policyholders should not be significantly advantaged or disadvantaged by terminating policyholders, and
3. Allow the cash surrender value to be an option rather than a required policy provision as under the current law.

The SOA and AAA have both been actively and diligently working on this project. We believe that this project continues to be necessary for several reasons:

1. The law should be one such that it permits new and innovative product design;
2. The current law has not fit well over the years as can be seen by the number of actuarial guidelines it has been necessary to develop; and
3. The required statutory tabular-based nonforfeiture formula, using mandated mortality and fixed allowances, does not necessarily give the intended results on new products compared to the traditional type of products for which it was designed.

With the current concern of equity between policyholders, is the current method of statutory design suitable for new product designs? We believe not.

The task force is at a point where it is ready to consider broader standards in statutory requirements rather than rigid narrow constraints. This can only be accomplished by relying on professional standards. The task force is considering empowering the professional actuary in the area of establishing nonforfeiture values.

INTRODUCTION AND OVERVIEW

The actuary is being relied upon to a greater extent in the area of valuation through the valuation actuary standard and also the current efforts in the new illustration regulation.

Let's consider some components for a current product.

1. Product design and pricing,
2. Statutory, mandated cash values must be considered and incorporated into the design,
3. An illustration is used during a sale,
4. Once issued, nonguaranteed elements occur over time for which the company must develop methods of determining such values and crediting such values, and
5. Valuation of such a product.

These areas may be distinct and separate from each other. In particular, some are developed utilizing different assumptions with respect to mortality, interest and expenses.

We are considering a "plan" approach. This means that a company would develop a plan for each policy form which addresses the key elements, assumptions and methods to be used in the design, issuance and maintenance of the policy. The plan will incorporate the initial assumptions into the nonforfeiture development directly rather than having statute dictate it. In other words, the nonforfeiture value will be permitted to be developed using the actuaries expected experience rather than a statutory standard. This should result in a more realistic policyholder value. It also means that different companies selling different policies may result in different values.

Another material change in this approach is that the nonforfeiture value will be developed considering total policyholder values, both guaranteed and nonguaranteed, and not limited to minimum values. This will require the direct integration of how the product was developed, and how it is illustrated and sold into the nonforfeiture development, i.e., the plan surrounding the policy. Remember, the plan will be the realm of the company and company management and not rigidly dictated by regulation. In particular, we are not looking into crossing the line into rate regulation or into setting limits on company profits.

1995 VALUATION ACTUARY SYMPOSIUM

The actuary will have greater liberties. The regulatory oversight will be a dual regulatory involvement of the state regulators and the overlay of actuarial standards of practice. The Actuarial Standards Board (ASB) is aware of these efforts and direction and has been involved in current discussions.

This should result in:

1. More innovative product design;
2. A law that should not go out-of-date as new products enter the market;
3. The ability to value products with combined benefit structures directly;
4. The ability to offer both fully guaranteed products, or products that pass on the experience to the policyholders as is currently desired;
5. Permitting no cash value products to assist companies in solvency concerns;
6. The regulation of the total product values rather than only the minimum policy values; and
7. Maintenance of basic equity over the total policy values.

NAIC Life and Health Actuarial Task Force

Annuity nonforfeiture law. -- It was decided to delay the adoption of the current annuity nonforfeiture law to see further development on the life law so as to maintain a degree of consistency between the two laws.

GGG. -- This guideline establishes basic reserves for annuity contracts. It is worth noting that the guideline is not limited to two-tier annuities as has been believed by some. It covers all individual annuity contracts.

The guideline basis establishes reserves by valuing each benefit stream of a contract. It is important to note that a "benefit stream" is not necessarily one type of benefit, i.e., a benefit stream may be a partial surrender, followed by a life annuity, followed by the payment of a death benefit. The entire benefit stream until full expiration of the contract values must be considered.

XXX. -- The regulation has been adopted by the NAIC, but not yet by any individual state. Most states are still considering it and investigating it. Because of recent publicity, we have asked the AAA to review the document and let us know if the basis is still considered to be correct.

INTRODUCTION AND OVERVIEW

The task force is undertaking efforts to adopt the new 1994 group annuity reserving table which the SOA released in its final report in May 1995. It is worth noting that this is a generational table. We will also be adopting Projection Scale G to be used with the current Table 1983 a.

Another project that the task force has had for approximately two years is putting together a question and answer document with respect to the NAIC model regulation on reinsurance. We have received a number of questions over time on the interpretation of some of its provisions, in particular, by states that were initiating adoption of the regulation. So we've put together an informal question and answer document, responding to some of the most commonly asked questions. That task has now been completed. The working group has passed it to our parent committee for final consideration. We expect maybe a couple of more minor adjustments and then full completion this year.

The NAIC has undertaken a major effort which is referred to as codification. If you are not familiar with it, or have not been following it, I strongly suggest that you start looking into it. Codification is establishing and putting down in writing the standards of statutory accounting into the *NAIC Accounting Practices & Procedures Manual*. It is not as some may believe, simply a rewriting of the document. It is putting in writing provisions that have not been in the document before, that have simply been believed practices or accepted practice. It is trying to make a complete, coherent document, similar to all the Financial Accounting Standards Board (FASB) listings.

Part of this may result in positions that are, in fact, changes from what has been accepted in the past. The reserving chapters will be coming out shortly. And those should be of interest to all of us. So you should take a close look at them.

We have asked the Academy to consider a couple of key aspects if there are some accounting or financial reporting standards that should be changed. AAA is still contemplating the request and should be getting back to us.

As an example, with the valuation actuary cash-flow testing, some of the reporting provisions on the annual statement may not be exactly consistent with how would you would do cash-flow testing.

1995 VALUATION ACTUARY SYMPOSIUM

When we do the streams of income and expenses, we take the premiums and build them directly into our cash-flow stream. Well, is it currently still appropriate then to put deferred premium as an asset category, or is it more appropriate to have deferred premium as an offset to reserves, similar to the Canadian approach? These are the types of things that we need to start looking at and strongly consider, due to the changes in how we practice. What are the impacts on accounting? This is the opportunity to make those changes now, while codification is still in its developing stage rather than after it gets finalized.

At least two aspects of the NAIC model Actuarial Opinion and Memorandum are being considered for amendment.

One is what has become known as the "this state" rule. Under the prior opinion, the actuary needed to simply state that the reserves follow the laws of the state of domicile. With the new valuation actuary law and the new regulation, there was a second requirement that reserves had to also be as great as that required in the state in which it was filed ("this state").

We have received a number of concerns that this is a very awkward matter and to some degree, somewhat impossible to comply with. We are taking this under consideration. There is a group that is putting together recommendations for our consideration as to how we could resolve this issue.

A second change that is being considered is what has been referred to as the executive summary to the actuarial memorandum. This is a document that automatically would be filed with the opinion and give the regulator certain detailed information which regulators could use to decide whether or not to request the filing of the full memorandum. We are looking at this to try and get away from requesting the full memorandum for many companies and just having a summary document that we could look at to get a better idea.

Another release of the Life and Health Actuarial Task Force is *Long-Term-Care Reserving Report*, which has been accepted and is in the process of final review and changes. We are currently also putting together amendments to the accident and health reserving model law.

INTRODUCTION AND OVERVIEW

The last activity that we have is a consideration of changes to the annuity valuation law. There is an Academy task force that is considering changes that may be necessary for the valuation of annuities. This would include not only changes to the current interest structure and formulas developing valuation interest rates, but also the underlying method of Commissioners Annuity Reserve Valuation Method (CARVM) and whether CARVM, as a worst case, should still be considered, or whether or not it is time to have some level of liberties. Continuous reserves clearly will be addressed, as well as other aspects of the law.

I believe that those are all the current efforts of the NAIC and I hope you can see that we are trying to keep pretty busy looking at all aspects of the areas of laws that will affect you. Hopefully, we will start bringing some of these to closure, and with your assistance and a little bit of luck, we'll get the right answers.

MS. DONNA R. CLAIRE: I will talk about a number of miscellaneous topics. One is the 1995 drafts of the Life Practice Notes. The notes have been reformatted and modified for easier reading, but, for those of you who want the cliff notes version: there are no major changes since 1994.

One of the changes that you will see in the Life Practice Notes is that they frequently refer to the *Dynamic Financial Conditions Analysis Handbook*, which covers what a number of people refer to as dynamic solvency testing. However, many of the topics covered for dynamic financial conditions analysis are also applicable to appointed actuaries.

For example, there is an extensive chapter on asset modeling. It suggests various assumptions that should be examined by those doing testing. In addition, each chapter of the book contains detailed bibliographies of sources of materials. Those who attended the 1994 Valuation Actuary Symposium received a copy of the book, which was officially published in April 1995; if you do not have a copy, you can purchase one from the SOA office. A survey recently released on Actuaries OnLine showed that at least one-third of those replying to the survey had not even opened the book. I would strongly recommend that you glance at this book for 1995 asset-adequacy testing.

1995 VALUATION ACTUARY SYMPOSIUM

Another note: the Life Practice Notes are being reviewed by the SOA's Committee on Life Insurance Practice Education this year. The chair of this committee is Forrest (Woody) Richen. You can send comments or questions to him at his yearbook address.

Another miscellaneous topic that I am covering is FASB and Securities and Exchange Commission (SEC) developments. There are no exciting developments this year, but there are a few things that I'd like to mention. The SEC has allowed a number of variations on the minimum death-benefit guarantee on variable annuities to be issued, and it appears that the general margins allowed on variable annuities have typically been increased in order to cover higher mortality and expense (M&E) charges. There are several sessions at this symposium, including Session 2, which will go into more detail on this subject. In terms of the statutory considerations of minimum death-benefit guarantees on variable annuities, John F. (Jack) Gies of the Connecticut Insurance Department will cover this in Session 20.

On the FASB side, there appears to be little current interest to develop fair market values of liabilities methodologies to go along with the required market values of asset calculations. However, there have been a number of good papers written on this subject by actuaries including one by David Becker titled, "The Value of the Firm: The Option Adjusted Value of Distributable Earnings," and a paper by an AAA group which discusses various methods of developing the fair value of liabilities. These papers will be published by the SOA within the next year. Session 11 will cover the question of fair value reporting.

Another item of interest to appointed actuaries is the official meetings of the actuaries and the accountants who meet twice a year. The official title of this meeting is the American Institute of Certified Public Accountants (AICPA) Relations With Actuaries Committee meeting with the American Academy of Actuaries Committee on Relations with Accountants of the Financial Steering Committee.

At the last meeting, the chair of the AICPA committee, John Bailey, noted that a company's considerations of its positive intent and ability to hold a security to maturity for purposes of valuing

INTRODUCTION AND OVERVIEW

securities in accordance with *FAS 115* might include the results of an actuary's cash-flow testing. Roughly translated, if your company is labeling assets as "hold-to-maturity," but they are frequently sold under cash-flow testing scenarios, this may influence your auditor as to the qualification of assets as hold-to-maturity under *FAS 115*.

Now let's discuss some topics that Frank Dino briefly mentioned. Another concern to appointed actuaries is the requirement that reserves meet the minimum standard for each state in which the opinion is filed. This issue was discussed at the Life and Health Actuarial (Technical) Task Force last week. The regulators showed sympathy to the problems this causes and urged work to continue on this issue. Shirley Shao of the Prudential is leading the effort from the industry side, and will have more to say on it in Session 14. This may be of concern to many of you, since Arkansas, one of the last states to pass the Dynamic Valuation Interest Rates, has passed the revisions to the valuation law effective for year-end 1995.

Always an interesting issue is any proposed change to the Actuarial Opinion and Memorandum Regulation. Larry Gorski of the Illinois Insurance Department is coordinating this effort from the regulatory side. It is expected that he will submit proposed changes to the regulation in December 1995. Since these have to be adopted by a state before they are official, there will be no changes to the regulation for this year-end. However, Larry is planning on releasing what has fondly become known as his "Halloween surprise," which will most likely indicate some of the changes he is advocating, including the requirements of the executive summary for Illinois. He has promised to give a preview of this letter in Session 20.

Another item of interest is what is going on with the regulation commonly known as XXX, which affects term insurance and other nonlevel death-benefit and/or nonlevel premium products. So far, the only state which has adopted a similar law is New York, with its Regulation 147. I have done a survey of a number of states. No one jumped up to say that it will be adopted soon. Larry Gorski of Illinois is expecting to have a January 1, 1997 effective date. Others are studying this issue. One state that will be interesting to watch is California, which has a bulletin issued in 1974, called 74-11, that has term-reserving requirements. California may enforce that bulletin this year.

1995 VALUATION ACTUARY SYMPOSIUM

There are a few more state issues. The first is that California has issued Bulletin 95-6, which requires actuaries to comment in their actuarial memorandum how immediate payment of claims is being addressed. This should be easy enough to do; actuaries just have to be aware of this requirement.

New York has issued a September 12 draft of proposed Regulation 150, which has statutory requirements for the valuation of annuities, GICs, and other deposits. This draft went to the Life Insurance Council of New York (LICONY) committee for review; it is expected that it will be released for general comments in October. It updates the statutory minimum annuity mortality rates to the 1994 Group Annuity Mortality Table for group annuities, and to the 1983 a Table with Projection Scale G for individual annuities. These new mortality tables would be in effect in 1997. Since many valuation systems take a while to change, it is useful to be aware of these new requirements early.

Another miscellaneous topic of interest to actuaries: the illustration regulation was passed by a midlevel NAIC committee on Tuesday, with a strong indication that this will be adopted as a model regulation in December of 1995. There is an accompanying compliance standard put out by the ASB. It is also expected to be adopted this fall. These documents require that all individual life illustrations will need to be backed by a disciplined current scale, which is signed off by a qualified illustration actuary by January 1997. Since some of you will also be the "illustration actuary" of your company, I recommend that you start the needed testing as soon as possible. I note that Commissioner Wilcox, prime mover of the illustration regulation, is at this symposium, so you can talk to him about your thoughts on this matter.

A major item, as Frank Dino has pointed out, is the possibility of the life nonforfeiture work, which will replace strict formula minimums with nonforfeiture numbers, developed consistent with a company plan. If this concept plays out, we may have major changes in life nonforfeiture, annuity nonforfeiture, illustrations, and valuations. I will try to keep you informed, and will request input via Actuaries OnLine.

INTRODUCTION AND OVERVIEW

MS. LAUREN M. BLOOM: The Actuarial Board for Counseling and Discipline was brought into existence by a vote of the membership to amend the bylaws of the AAA effective January 1, 1992. Although the ABCD can therefore be considered to be part of the Academy, all five of the United States organizations representing actuaries have delegated to the ABCD, through their Codes of Professional Conduct, complaints and questions that arise concerning their members' professional practice.

In almost four years, the ABCD has addressed nearly two hundred cases, a statistical sample of fairly significant size. Although each ABCD case is unique, some trends have begun to emerge that may be of general interest to the actuarial profession as a whole.

First, the ABCD has found that complaints are filed against actuaries in every type of practice: in-house, consulting, government, and others. Consultants tend to be complained about most often, but this appears to be largely attributable to the fact that the consultant/client relationship tends to be different, and perhaps more distant, than the typical relationship between employer and employee. In-house actuaries should not, therefore, assume that they are immune from being brought before the ABCD.

Second, the ABCD has found that complaints come from every conceivable source. The ABCD has received complaints from clients, coworkers, competitors, regulators, attorneys, opponents in litigation, and the press. In a few instances, the ABCD has initiated investigations on its own without first receiving a formal complaint when a possible violation of professional standards has come to its attention.

Third, no one practice area has been particularly singled out for complaints. Pension practitioners tend to be the most frequent objects of complaints, but this may be due in part to the fact that many pension practitioners are consultants working for small pension plans, an area of practice that is often fraught with conflict. Life practitioners, casualty practitioners and health practitioners have also been the subject of complaints, usually in numbers that are roughly consistent with overall practice area representation in the profession.

1995 VALUATION ACTUARY SYMPOSIUM

Fourth, the ABCD divides its cases into three categories: conduct, practice, and some combination of the two. We have discovered that the vast majority of ABCD cases have involved some conduct question. Pure questions of practice where the actuary's conduct is not also at issue are relatively rare.

Fifth, we have learned over the years that many practicing actuaries are leery of being brought before the ABCD. When a case first comes into our office, a staff representative of the ABCD often contacts the actuary who is the subject of the case to advise the actuary that the case has been received and offer an opportunity for an initial response. The actuary more often than not responds in a panic.

This reaction to the ABCD, although understandable, is usually unwarranted. Of the nearly two hundred cases that the ABCD has considered, only three have resulted in recommendations for public discipline. All the other cases that are not still being investigated have been resolved through outright dismissal, confidential counseling, or something in between. Thus, while one cannot predict what action the ABCD will determine is appropriate in any particular case, the statistical history suggests that public discipline is unlikely in most circumstances.

In nearly all instances, of course, the actuarial profession as a whole never learns the details of individual ABCD cases, because the ABCD's proceedings are kept confidential. Consequently, practicing actuaries may not be certain of what conduct to avoid. The ABCD recognizes the importance of helping actuaries comply with professional standards and using examples from its cases of particular instances where an actuary's conduct or practice was inconsistent with the actuary's professional obligations. To that end, the ABCD is preparing case studies (based on actual cases that have come before it with identifying facts removed or altered) that will contain specific guidance for actuaries on how to comply with professional standards in a similar situation. Additionally, the ABCD is also publishing a series of articles in *The Actuarial Update* and other actuarial newsletters concerning issues of general interest out of its cases. The ABCD has also produced a new video, which is being shown at actuarial meetings and is featured in live presentations about the ABCD and its ongoing activities.

INTRODUCTION AND OVERVIEW

The last, and most encouraging trend that the ABCD has seen since its inception is a slow but steady increase in the number of voluntary requests for guidance received from actuaries each year. The ABCD's primary function for the last four years has been to counsel, and not to discipline, the actuarial profession. Members who submit these requests are learning that the ABCD is a valuable source of confidential advice for dealing with sticky professional issues. As ethical questions arise in your professional practice, consider seeking guidance from the ABCD. It is far better to ask advice before you act than to have to defend your actions to the ABCD after the fact.

It has been a real pleasure to work with the ABCD since its founding, and I look forward to continuing to assist the ABCD in its efforts on behalf of the actuarial profession in the years ahead.

MR. SMITH: One of the things that Frank Dino talked about with respect to GGG was that GGG apparently seems to read that you take each individual benefit stream and value it, and then you take the greatest of all of those. Frank mentioned a fact that maybe is not crystal clear and I just want to reemphasize it. Combination streams are possible.

There is an article in the August 1995 issue of the SOA's *Financial Reporter* newsletter that I would think most or all of the regulating actuaries of the LHATF would take at least some issue with. In particular, the article indicated that, for single premium deferred annuity (SPDA) death benefits, you take the present value of all the death benefits, which was about \$7,000 in the example, versus the present values for all the different kinds of benefits, such as surrender or annuitization benefits, which were about \$15,000-\$19,000. Combination streams are and should be considered.

A comment was made about the 1994 Group Annuity Reserving Table. The LHATF, and I believe, New York and regulation 150 are looking at putting in something also for updating the 1983 a table, on a generational basis. You need to prepare for that in advance a little bit, because generational type of programming is different from what many companies currently are doing.

One last observation on the life nonforfeiture law. I saw some of the examples that were made in the presentation to the LHATF last week, and when it says it's new and different, it really is.

1995 VALUATION ACTUARY SYMPOSIUM

Let me just give you two examples that really caught my eye. Suppose you have a plan that is being filed and let's say, for example, that, for whatever reason, you feel that interest rates in the future are going to be higher than you originally had in the plan. What that will actually mean is that cash values and minimum nonforfeiture values will go down, not up. It's kind of counterintuitive. It's sort of like a market value on a 20- or 30-year bond. If interest rates rise, the market value goes down.

Another counterintuitive example involves the mortality assumption. Suppose, because of a nuclear accident, you assume mortality would go up by 50%. Well, that would lead to higher, not lower, minimum values because the "value" of the death benefits is now higher. This is really very new and different and presumably, once the nonforfeiture is in place, we will be taking a look at the valuation laws to make them coincide in some way.

MS. CLAIRE: We are trying to get at least the SOA draft report on Actuaries On-Line. It will be in the Life & Annuities Library section.

We went back to basic principles and sort of explained why certain things may happen. We are, in general, looking at the benefits of the persisting versus terminating policyholders. The way you can most easily measure that is on a prospective basis, but again, it's something very new and different and would have a major impact on the industry. We think it will be a major positive impact, but we would like to know what the problems are before we get too far down the road.

MR. SMITH: Frank, do you have any ideas about your target date for the NAIC life nonforfeiture regulations? When do you think they will come out?

MR. DINO: It's a little premature to get target dates, but what I'm hoping is that between now and December, that we refine some examples and some modeling of what this approach will do. We hope to have more specific types of product, an illustrative type of a plan structure, and possibly, by December or shortly thereafter, to have an initial draft document of a law. If things progress smoothly, and we have a lot of interaction with the industry and the actuarial profession to resolve problems expeditiously, I'm very hopeful to complete the project by next year.

INTRODUCTION AND OVERVIEW

MR. JAMES E. BACKUS: Can you let us know where we stand on the possible extension of CARVM to group annuities?

MS. CLAIRE: One advantage to the life nonforfeiture is it's sort of taking up all the time. The annuity valuation committee under Doug Doll and Errol Cramer, is looking at the rules that would apply to all annuities, including groups, products, variable, group and deposit funds, GICs, SPDAs, SPIAs (Single Premium Immediate Annuity), structured settlements, etc., that have to be changed. The committee expects to have a report by December, but work will be continuing throughout the next year.

MS. R. LISA LEFKOWITZ: This is based on what Frank said, but I don't know who would be the most appropriate person to answer it. If I understood him correctly, life nonforfeiture values will be based on the actuary's professional judgment instead of on the regulations. Could you comment on how this could transform cash values into a marketing tool and the good and bad things that come from that? Also, please comment on the fact that if a policyholder were to complain to a state insurance department, it is the ABCD that is supposed to discipline actuaries on their professional conduct.

MR. DINO: Yes, you're correct that what we're considering is to use the actuary's judgment on experience in developing nonforfeiture values. And we always try to discuss it as nonforfeiture values rather than cash values, because they may not equate. We will not be looking at requiring the cash values. Different companies will have different values that will be driven based on their unique situation, their expenses, their margins, their type of marketing structure. It will be tied to illustrations, how they create and monitor and credit to the policy. Everything will tie together, but that will create competitive advantages and disadvantages.

It will be purely the company creating its position in the marketplace. It could be aggressive or not so aggressive, as opposed to an artificial value that everyone must live with, indifferent of their margins and their actual expense designs.

1995 VALUATION ACTUARY SYMPOSIUM

The ABCD will not directly be the regulator, but you're correct that it indirectly will be. The state regulatory body will still be the responsible party. It will use the ABCD as part of its review and monitoring tools. That is, the regulators still could use standards of practice in the review, not just the actual statutes.

We will go to the ABCD if we believe a professional standard has been breached and we wish its assistance and guidance. But we're not going to defer our regulatory responsibilities over to them. Hopefully, the plan will be such that an independent actuary, whether it be the state actuary or consultant, could go into the company, review the plan and be able to reproduce the values.

So the values could still be tested the way they are currently, but you'll not get simply the same answer by company. It would have to be detailed in the plan and the plan would have to be that detailed in order to be acceptable.

FROM THE FLOOR: Wouldn't that slow down the state approval process significantly?

MR. DINO: With the contemplated new approach, the state approval process would have to change. The regulators are in for as much of a change as the industry is. And we will have to change our procedures regarding how we monitor and review as opposed to what we're currently doing, which is looking at all values. Yes, the approval process will be affected. Hopefully, it could be incorporated in a way so as to not slow down, but possibly even to expedite the review process by having other reliances.

MS. BLOOM: I should add, by the way, that the ABCD is in some ways, almost misnamed. One could argue that it ought to be called the ABCI, which is to say the "Actuarial Board for Counseling and Investigations." The ABCD itself does not have the authority to discipline anyone. What the ABCD has is the authority to investigate complaints against actuaries or questions involving the actuaries' professional practice. That can lead to a recommendation to your membership body, that an actuary be publicly disciplined. But ultimately, it's up to the AAA, the SOA, or whomever, to make the decision to do that public discipline.

INTRODUCTION AND OVERVIEW

MR. JAMES R. THOMPSON: Someone mentioned something about the illustration actuary and I haven't seen the latest update on that, but the earlier draft from June raised a lot of concerns about the onerous nature regarding expenses for the current dividend scale. However, I was told that a more recent version has changed that and I was wondering if someone could address that for a minute.

MS. CLAIRE: There have been no major changes in the regulation. The compliance guideline or actuarial standard of practice has been somewhat clarified in this nature. I would still recommend reading it very carefully to find out exactly what the obligations are in terms of expenses. What it comes down to is you have to do full allocation of expenses.

Start-up companies are trying to develop generally accepted expense limitations, or expense factors. Those have not been developed yet. But even these will be fully allocated expenses.

One of the things the Life Practice Council has asked me, as chair of the Practice Notes Task Force, is to try and come up with something on this one. I will, as soon as the document gets finalized, but it is still an issue of contention. However, as I said, the regulation is, in all likelihood, going to be passed, as is.

MR. ROBERT E. WILCOX: I'm the insurance commissioner for the State of Utah and the chair of the working group that has developed the model on life illustration that has just passed through the A Committee the day before yesterday. I'm not going to debate you. I'm just going to clarify slightly, on the expense issue and the way that is treated in the model that was passed.

We did have to move part of this into the regulation in order to not have antitrust issues with the standard of practice. Essentially, there are three ways in which the expense assumption can be addressed. One is using a fully allocated expense that will always be acceptable. That means using a company's actual recent expense experience. Second, a company can use a marginal expense assumption where only the marginal costs are recognized, as long as that does not produce a value less than the third alternative, which is an approved industry average table.

1995 VALUATION ACTUARY SYMPOSIUM

The industry average table will also be a fully allocated table, and that must be based on a substantial portion of the industry. Those of you who are familiar with the Milliman & Robertson expense table or the Tillinghast expense table, will recognize that those are close to what is needed, but not quite there, so we're going to be asking the profession to come up with an industry average table in the next few months, so that it can be adopted.

If, in fact, no table is prepared and adopted, the regulation defaults to a fully allocated basis of expenses which is essentially where the working groups started out. However, we were persuaded by the Life Committee of the ASB that we ought to allow this additional level of flexibility with regard to the expense assumption.

Just a couple of other comments on the illustration model and then I'll sit down. First of all, while this has passed through the A Committee, the final approval is with the Executive and Plenary Committees, and will occur at the NAIC's December meeting in San Antonio.

If there are material problems that come up with the model over the next three months, it will be important for you to get that information back to us. We're committed to have the best model we can. We think we're there, but if there are problems you identify that we need to give additional consideration to, we have the next three months in which to do that.

For those of you who are not familiar with this particular nuance of terminology, the ASB has determined that it will call all of these things standards of practice, even though some and this one in particular is really a compliance guide. So when you read standard of practice, put in parentheses, compliance guide. The ASB will meet in October to put any final touches on the current draft of the standard of practice.

A lot of work has gone into preparing this model, but clearly the job is not done, since the scope of this applies only to nonvariable life products. It does not apply to variable life products. It does not apply to annuities. The next task we will undertake is to deal with variable life products.

INTRODUCTION AND OVERVIEW

It is important that we not advantage or disadvantage either of these products in the marketplace, by virtue of the requirements for illustration. So our challenge will be to take something that is similar in many ways, but different in other ways, and come up with an illustration that will provide for a fair market price presentation. That is our next task.

If any of you would care to be added to the list of experts that we call on for assistance in developing this model, please submit your name to me or to Caroline Johnson at the NAIC, because we need people who have that special level of expertise on variable products, to make sure that we come up with as good a work product in this area as we have on the nonvariable side.

MS. CLAIRE: I just want to add, again, we may not always agree, but Commissioner Wilcox is very open to getting the best document out as possible. So I have really enjoyed working with him.

MR. ROBERT H. DREYER: Frank, you described what we might refer to as dynamic nonforfeiture values for the indeterminate premium product. What will this do for the company that wishes to issue standard guaranteed whole life?

MR. DINO: A fully guaranteed product will still be available and fit within this design. The plan will simply design it such that it guarantees the value at inception, based on the expected experience over the duration of that policy, as opposed to having the ability to change with experience. So either you freeze the experience at inception or you can pass that experience development onto the policyholder. This plan design will be totally open. Both will be available.

