

**1995 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS**

SESSION 2

Life and Annuity Valuation Issues

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MR. ERROL CRAMER: Our speakers are Doug Doll and Craig Raymond. Doug is a consultant with Tillinghast-Towers Perrin in Atlanta. Doug and I cochair the American Academy of Actuaries Annuity Valuation Task Force, and he's also on the Society of Actuaries Nonforfeiture Task Force. So Doug is certainly well-qualified to provide us updates on these two groups. Craig is chief actuary with ITT Hartford. Craig is a member of the American Academy of Actuaries Committee on Life Insurance, and is also on the Society of Actuaries Financial Reporting Section Council. Craig is also on the American Academy Working Group for the Variable Annuity Minimum Guaranteed Death Benefit Reserve.

We're going to focus on four current and topical issues for life and annuity valuation. Doug will start off with an update on the Standard NonForfeiture Law proposals for life and annuities. Craig will then talk briefly on Regulation XXX. There are follow-up workshops that will go into XXX in more detail, but not everyone has the same interest in life reserving. So Craig will provide an overview, and Doug will then talk about the American Academy's latest status on the Annuity Valuation Task Force. Finally Craig will talk about the separate accounts.

MR. DOUGLAS C. DOLL: One year ago, Howard Kayton stood before this same group and announced that the one-year annuity nonforfeiture law project, which had been started four years previously, was finished, for all practical purposes, and he had high expectations that it was going to be adopted soon. So now I'm here to say that this one-year project is now five years old and the end is not in sight.

Why is that? Those of you who have been following the issue recall that, about three years ago, it seemed like the structure of the new annuity nonforfeiture law was fairly well in place. Well, there's been a couple of things that have served to delay the law. The first delay was a fairly large controversy with regard to two-tier annuities. The regulators wanted to restrict the maximum surrender charges in an annuity contract to 10% of premium or 10% of fund. The two-tier-annuity

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companies presented arguments as to why that was not sufficient and why it should be larger, and that argument went a long way toward delaying the adoption.

More recently, there has been a different issue that has supplanted the two-tier annuity as being the most controversial, a new section 16B, which is a certification that nonguaranteed elements are "consistently and equitably determined and applied." That's the wording as of June 1995. This is meant to address the regulators' concerns about persistency bonuses, and about bait-and-switch-type illustrations. The industry is quite concerned about that wording and that controversy has delayed it a few more months. Then, we have a situation where the developments on life nonforfeiture threaten to overwhelm annuity nonforfeiture, and so annuity nonforfeiture has been put on hold.

Given that it has been put on hold, I'm somewhat hesitant to go over the provisions that are in the latest draft of the annuity nonforfeiture law, but I promise to keep it short. I think it will be interesting to go over the provisions of the annuity nonforfeiture law, because we will see just how different this structure is that's being proposed for life nonforfeiture. Annuity nonforfeiture is the opposite of proposed life nonforfeiture. Everything is strictly controlled. The current draft of the proposal for the annuity nonforfeiture law would allow three types of annuities. Continuous access is the type we're most familiar with; that means there is always a cash surrender value available in the product. The no-cash-value annuity has been available in the past. It's just not very common. It continues and will be an option. And then there's a third option that's not available on the current law, which is called restricted surrender provision. That's the so-called certificate of deposit or CD annuity, where you have a guaranteed interest rate that runs for a few years, anywhere between three and ten years, and the cash surrender value is only available at the end of that guaranteed period.

The sales load restrictions in the new law are 20% of the first \$10,000 of premium, and 10% of any excess premium. However, that \$10,000 of premium that you have the 20% limit on is limited to \$3,000 per year if the product is not tax qualified. That was sort of a controversial provision, too. The regulators are quite concerned. For nonqualified business, they really did not want to go above 10%.

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The guaranteed minimum interest rate is 2.25% or a rate specified by the commissioner if lower. Maximum policy fees are \$40 per year and \$1.25 per premium collection, and that's not indexed.

The ratio of cash surrender value to account value cannot change by more than 2% per year. One thing that requirement would prohibit is cliff surrender charges, and that was somewhat controversial. So, recently, a provision was added to say that you can increase the ratio of cash surrender value to account value by more than 2% a year, if you grade that ratio to 100% by the end of year ten. So you can now have cliff surrender charges but not after policy year ten. Also, the current provision for two-tier annuities does allow surrender charges as large as 20%, under certain conditions. Specifically, the 20% has to grade back down to 10% by the later of age 65 or ten years, but not later than age 75, and you have to provide certain favorable annuitization provisions.

The law would allow a general account market-value adjustment, but it would be limited to 25% of the account value if the product was not registered with the Securities and Exchange Commission (SEC). One of the goals of the new nonforfeiture law was to bring in all group contracts. Actually, the real goal was to sweep in pseudogroup contracts, because some policies were being sold under a group contract to groups that really weren't what we would consider true group. It was a concern that this was just being done to escape the provisions of the nonforfeiture law. So all group contracts are covered with certain exceptions. Well, this exception list keeps growing, and that's now up to eight different exceptions for group contracts. But the basic intent is just the pseudogroups should be covered by this nonforfeiture law.

All right, let me move now to the proposed new life nonforfeiture law. I've been involved with the proposed revisions to the life nonforfeiture law since 1986. I started out on an Academy of Actuaries Task Force and then later served on the Academy of Actuaries committee. Now I'm on the Society of Actuaries Task Force that Donna Claire chairs. So this has been going on for a number of years. Basically, it has been going on ever since the universal life model regulation was adopted by the NAIC. The regulators were not happy with some provisions in that. At first, the concerns were just universal life, but the concerns gradually grew until they encompassed all of life nonforfeiture. Until March 1995, all proposals to revise the nonforfeiture law were basically proposals to change the

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formula minimum basis. And some of the proposals were maybe similar to what we have now. Some of the proposals were retrospective rate regulation, but they were all formula proposals.

They all failed for various reasons. None of them could satisfy both the regulators and the industry. Some of them didn't satisfy anybody, except those who proposed them. In March 1995, the NAIC decided to go back to basic principles, and the Society of Actuaries and the Academy of Actuaries were asked for their input. The key principle that the task force came up with is that persisting policyholders should not be significantly advantaged or disadvantaged by terminating policyholders.

That's the basic principle that the Society of Actuaries group had to work with. It's a little bit hazy as to what the Society group is doing versus what the Academy group is doing. The Society is basically doing the principles part of it, and the Academy is working on the practical part of it.

The Society of Actuaries task force came to the following conclusion: if we're going to talk about parity between terminating and persisting policyholders, that's a prospective viewpoint. We look at what the persisting policyholder is going to get in the future, and the value of that should be what the terminating policyholder gets. The second thing is that the value to the persisting policyholder includes nonguaranteed elements, so we have to include the value of nonguaranteed elements in whatever we come up with.

By including nonguaranteed elements, we need to take into account the plan that the company has for future crediting of these nonguaranteed elements. And then finally, just continuing on the train of logic, if a policy is being sold with the plan for these nonguaranteed elements, it makes sense that there should be some restrictions on changes to that plan. A company can't arbitrarily change the plan after issue.

If you take all those conclusions into account, you get some results. One result is we're going to get smooth nonforfeiture values. We will no longer have very large persistency bonuses that kick in a lump sum at some duration. The values will grade up to whatever the maturity values should be. Another result implies the regulation will eliminate bait-and-switch illustrations, if we have a plan that

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needs to be followed. And third, the regulation implies that nonforfeiture values are going to vary by company.

The other principle that we addressed is that, if we're talking about a nonforfeiture value to the terminating policyholder, the value doesn't necessarily have to be a cash surrender value. It can be a paid up value. We're taking the approach that we have this minimum nonforfeiture value, but that does not necessarily imply required cash surrender values.

I mentioned that the viewpoint is a prospective viewpoint; however, a retrospective formula can work. The formulas are still being derived, but clearly, if the assumptions are the same, then from a retrospective basis and a prospective basis, you are going to get the same values. Also, Steve Smith mentioned that some of the examples shown show anomalies. The value of mortality goes up and the value of the nonforfeiture value also goes up. I guess this makes sense when you think about the fact that to the persisting policyholder, if you have a guaranteed contract and mortality has gone up, it's worth more to the persisting policyholder. So if you're going to give the terminating policyholder the same value, he or she should get more, too.

Now as a practical matter, I think we're going to find that we're going to have policies sold on a completely guaranteed basis; that's going to be permitted. So those policies of nonforfeiture values won't change if the mortality assumptions change. And if we have products with nonguaranteed elements, companies will change their nonguaranteed elements in response to the change in the mortality. So if you have a participating whole life policy, and mortality is assumed to go up 20% in the future, the dividend scale is going to be changed to adjust for that 20% increase in mortality. And if the dividends are changed to adjust for that, then basically, the value to the persisting policyholder has not changed, therefore, the nonforfeiture value to the terminating policyholder also will not change.

Donna Claire is chairperson of the Society Task Force. Randy Mire is chairperson of the Academy Task Force. They are working on specifications, formulas, examples, and possible wording for a new law. From March through the September 1995 NAIC meeting, they've come up with all the concepts.

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That's the fun part. The devil is going to be in the details. Actually coming out with the specifications for the formulas is the most difficult task. Some of the complexities that they've already encountered are, what do you do if the theoretical nonforfeiture value is negative? Obviously, we can't charge the policyholder something extra to terminate, so we have to do something with that loss that's going to occur if somebody surrenders in the first year of a policy with a negative nonforfeiture value.

How do we come up with a set of nonforfeiture values for a flexible premium product, where we don't know, at issue, just what the benefits of the policy are going to be? What do we do if we have certain policy options, as in universal life, the ability to switch from an option A to an option B? That might affect the values.

Another problem that comes up is, what do we do if a company wishes to provide cash surrender values that are higher than the theoretical nonforfeiture values? Should we permit that? There are questions that have come up with regard to the plan. How detailed should this plan be? If a company has to prepare a plan, and it has to be available to regulators, there are questions as to how detailed that plan should be, how much disclosure, if any, should be made to policyholders, and under what conditions changes can be made to the plan.

I'd like to conclude this presentation on nonforfeiture by sharing some of the information given at the most recent NAIC Actuarial Task Force meeting by Randy Mire. Basically, we're talking about a paradigm shift on nonforfeiture values, going from a formula basis to, if you will, an actuarial basis. We're going to go from minimum nonforfeiture values, based on "well-established and widely recognized companies operating on relatively high expense rates," which is a quote out of the Guertin Committee Report, to actual nonforfeiture benefits based on individual company experience with no statutory minimums.

We're going to switch from guaranteed cost policies, which have prescribed minimum values, to a system where values for guaranteed cost products would have an actuarial certification at policy form filing -- the nonforfeiture values are determined according to "nonforfeiture basic principles." We're

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going to switch from required guaranteed nonforfeiture benefits to optional guaranteed nonforfeiture benefits, but the actuary must certify that actual nonforfeiture benefits are determined according to nonforfeiture basic principles. And this is going to require that actuarial standards of practice be set up.

We're going to switch from required cash surrender values to a situation where cash-surrender values are optional, but paid-up insurance and life annuity payment options will be required. And finally, we're going to switch from a plan for determining nonguaranteed elements that currently does not need to be filed with the state (although there are no requirements for such a plan, we would note that *Actuarial Standard of Practice No. 1* requires that a plan exists for determination or redetermination of nonguaranteed elements) to a plan for determination and redetermination of nonguaranteed elements that would need to be prepared. The plan would be available to state regulators. The state would be notified each time the plan is changed thereafter. The actuary must certify that the plan complies with nonforfeiture basic principles. Furthermore, the actuary must certify annually that the plan is being followed. That's the essence of the proposal that was made to the NAIC.

I think we might look to the results of the sales illustration regulation to get some idea as to what will happen to life nonforfeiture because there are some similarities between the two. They both require additional reliance on the actuary.

MR. CRAIG R. RAYMOND: I'm going to touch briefly on Regulation XXX. There will be a follow-up, detailed teaching session for those of you who want to get into the details of exactly how this works. And I'm glad Errol didn't ask me to talk about that, because that's something that I'm not overly interested in getting into. There will also be a workshop that will follow-up on some other issues.

I'd like to give you a brief overview of what we like to call Regulation XXX. This regulation started out a number of years ago as a proposed guideline. The proposed guideline name that was given to it was Guideline XXX. This guideline was originally a response to regulatory concerns over a broad and developing industry creativity as to product design on term products, that was resulting in much

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lower reserves than a number of regulators felt were appropriate. Their request to clarify exactly how reserves should be calculated on term insurance led to the development of Guideline XXX. The ACLI was asked to participate in developing a proposal. The ACLI committee members worked for a number of years; I wish I knew how long, but I know it was a long time. As they worked, they finally realized that the appropriate response to this problem was the adoption of a new mortality table. As they expanded their charge to the adoption of a new mortality table, their charge moved beyond the ability to be adopted by actuarial guideline at the NAIC. So that's why it became a regulation. Because a guideline cannot create law or regulation. It can only interpret it.

Another issue that also came up along the way, during the development process, was a new creative twist of using a universal life structure to provide term type product guarantees. This raised some concerns as far as whether or not those guarantees were being appropriately reserved for. There was some initial discussion at the NAIC as to adopting a guideline that would address that issue. The discussion moved quickly towards folding this issue into the Guideline XXX proposal.

As I hope most of you know, along the way, New York also developed its version of this regulation, which is fairly close to the final version of Guideline XXX, and I'm sure the follow-up sessions will get into the details of where it differs. This was adopted as Regulation 147 in New York, and is effective as of January 1, 1994.

It's important to keep in mind that XXX is not just a term regulation, although most of us like to think of it that way. The scope of the regulation applies to all life insurance. However, it practically only impacts plans with nonlevel premiums or benefits and universal life products with secondary guarantees.

Briefly, XXX allows increased select mortality factors for the 1980 CSO table to be used for valuation for minimum standards and for deficiency reserve calculations. It requires the reserve that is held to be the greater of the unitary reserve, which is a reserve calculated over the life of the product, or a segmented reserve. The segmented reserve methodology is a fairly detailed methodology and is defined in the regulation. This methodology essentially depends on defining

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segments based on the relationship of the pattern of gross premiums to the pattern of underlying mortality.

The regulation also clarifies that the minimum reserve can never be less than $\frac{1}{2}C_x$, which, for some companies, appears to be a much bigger issue than I thought it was. I didn't think this needed clarification, but apparently, it was an issue that was raised and needed to be clarified.

In addition, XXX affects reserving for universal life plans with secondary guarantees. The specific concern addressed here deals with a term plan that is hidden in a universal life plan. These plans will have an additional guarantee that, if a certain premium is paid for 15 or 20 years, then the policy will not lapse, despite the fact that there may not be a positive account value on the policy. Essentially, this allows the policy to operate like a 15- or 20-year level term. The universal life model regulation for valuation does not provide for any recognition of the underlying guarantee in valuation. XXX essentially requires you to hold the greater of the base reserve calculated under normal universal life methodology, or the reserve calculated treating it as a term policy following the guarantee.

Since the adoption of this regulation by the NAIC, there has been a great deal of industry and public discussion about the necessity of it and its effects. It has become a political issue in a lot of states where the discussion has gone beyond the actuarial community. There is currently active involvement of the commissioners in many states. Letters have even been written to state governors explaining how bad this is for consumers. This public attention to the matter has slowed down the adoption of the regulation. The NAIC is taking a closer look at it. The NAIC has gone back to the Academy and asked for its current view of the appropriateness of the regulation.

I've talked to a number of regulators recently, and as far as I know, at this point, New York is the only state that has acted on the regulation. Most states at this point are still looking at it and considering what their action will be. My opinion is that this regulation continues to be necessary. Clarification of reserves is appropriate in this situation. Although the regulation is very complicated and probably not the best or theoretically the most appropriate answer, it is the result of a lot of work

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and a lot of compromise. I think it gets to the issues that need to be resolved. Not adopting the regulation at this point would be a step backwards.

After talking to a number of regulators (again, this is just my reaction and I could be totally wrong on this), I will be surprised if any state takes action on this between now and year-end. I do expect there would be a large number of states that will adopt it in 1996. If you're looking at planning, I would expect, beginning in 1997, for many states outside of New York, you're going to have to be looking at complying with the regulation. I will be surprised if it is adopted countrywide, which will be a nightmare for a lot of companies, because of the complications and the effects it has on product design.

One other issue I did want to touch on is the effort of the NAIC on codification. I'm sure that a lot of you have not paid a lot of attention to codification. It seems like an effort that the accountants are making, that we hope won't effect us too much. The effort on codification is a very serious and broad effort at the NAIC. The people working on it are not just looking at codifying current practice. They're also looking at changes. At the NAIC meeting last quarter, it was mentioned that the scope of this project is such that, where you now have an accounting manual on your bookshelf, you can expect that when the process is done, you will need to get a new bookcase to fill it with new codification standards. That's going to have an effect on all of us. A number of reserving issues may even be imparted by this process. It is an issue that we, as financial reporting actuaries, should all be paying attention to. We should make sure that where we have opportunities that relate to our work to make things better, we get involved, and where there are things that come up that affect us that we're concerned with, we don't just let them slip by.

MR. DOLL: Errol and I are cochairing an Academy task force to come up with a recommendation for changes to annuity valuation. Some of the things that we are talking about doing in our task force seem awfully complicated, but I guess whenever we look at Guideline XXX, we come back to the realization that maybe complication is not so bad after all. Everybody seems to accept it these days.

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Before I talk about changes to the annuity valuation law, I'd like to do something unusual for this panel and talk about something that actually has been adopted: Actuarial Guideline 33, otherwise known as Guideline GGG.

First of all with respect to Guideline GGG, it's not like Guideline XXX. This actually is a guideline as opposed to a regulation. That means it's effective at the NAIC level. It's effective at year-end 1995. It's effective in all states with this one caveat: a state can choose to override Guideline 33, but should assume that, in the absence of any guidance from the state, Guideline 33 does apply. I've had a couple of people ask me, and I've heard that a couple other people say they were asked, what the prognosis is for state adoption of Guideline GGG. The answer is, states don't have to adopt it. It has been adopted.

As already described, Guideline 33 requires valuation of all benefit streams, where the primary benefit stream that the authors were targeting was annuitization. One of the side features in it is, if there's a contractual right to annuitize on the company's current basis, the minimum reserve is 93% of the fund.

Guideline 33 does *not* address the issue of continuous versus curtate commissioner's annuity reserve valuation method (CARVM). Guideline 33 talks about the greatest present value as specified in the Standard Valuation Law. So whatever position a state has taken on continuous versus curtate CARVM, those positions still apply in those states.

There was an article in the August 1995 *Financial Reporter* by Bob LaLonde. I have two things to mention about the article. The first thing is a typo or I guess we can regard it as a typo. I'm going to call it typo because even though Bob LaLonde wrote the article, he had it reviewed by some people. I was one of the reviewers and I didn't catch it, so, I don't want to cast mud at Bob because I'm just as much to blame. It talks about the valuation interest rate to use for annuitization, and it says that you would use Plan Type A valuation rates, unless the annuitization period is five years or shorter. Otherwise, you use Plan Type C. It should have said, if the annuitization period is shorter than five years.

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And the other thing is a clarification from the regulators at their last meeting, because it's certainly not clear from reading Guideline 33 itself. And that is that you could use mixed benefit streams. Let me give an example. Let's say you have a fairly large death benefit; in fact, one of the examples that was in the article was an extra thousand dollars in accidental death benefit layered on top of the regular annuity benefit. Guideline 33 would say, one of the benefit streams you would look at in coming up with the greatest present value would be the greatest cash value. The greatest reserve as far as looking at the cash surrender values would be at the end of five years. You would also consider during that five-year period, how many people have died and look at what their death benefit is. Your benefit stream is that certain percentage of the people who died during that first five years. The remainder collect that fifth-year cash value. You have this mixed benefit stream that you should discount back. If your death benefit was higher than what the reserve effectively was during that five-year period, you're going to get a slightly higher reserve. Interestingly, Guideline GGG specifically says, when valuing the cash surrender value stream, to ignore mortality. There's a little bit of an inconsistency there.

I'd like to now turn to the proposed new annuity valuation law. This is a relatively recent regulatory initiative. It only dates back to 1991. In 1991, there were a lot of concerns that the regulators had about how to apply CARVM to different annuity plans. One of the big issues at that time was continuous versus curtate. The Academy of Actuaries Life Committee came out with a paper on how to interpret the Standard Valuation Law using the existing CARVM. It came out in draft form and really didn't change things a whole lot, but it did prompt the NAIC's actuarial task force to appoint a technical resource group in 1992. This group, chaired by Dennis Stanley, was to just review the whole annuity valuation law and propose changes to bring it up to date and to alleviate some of the perceived problems that existed.

Denny's group, which basically comprised most of the people who are on the current Academy task force, developed some interim reports. They came out with more or less a final report in 1994, although maybe they didn't think it was the final report at the time, but there was a report and it had some tentative recommendations. At the end of 1994, technical resource groups were eliminated by

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the NAIC, and the Actuarial Task Force asked the Academy to continue on the efforts that the technical resource group had begun and bring them to closure.

First, I'd like to go over some of the valuation issues that prompted the formation of the group in 1992. This is the laundry list. There was a question of what to do with contingent benefits, things like nursing home riders, or nursing home waiver or surrender charges and bailout provisions. The issue of continuous versus curtate CARVM was and continues to be a topic of discussion.

Another topic was GIC plan types. What should the plan types be for certain types of GICs that have book value cash outs? Some of these issues have subsequently been addressed by the regulators. For example, Guideline 30 addresses the GIC plan type. Another question relates to annuitization options: specifically, whether or not these should be valued and/or how they should be valued. That's been taken care of in one way by Guideline GGG. It may not be to everybody's satisfaction, but at this point, we're going to have to change the law, if we want to change what's in there. Variable annuities are not covered by CARVM, and there's a question of how CARVM applies to variable annuities.

Most annuities are valued using a 12-month average of a Moody's Index that ends in June, so effectively, you have a six-month lag on the valuation rate for a given calendar year's issues. If you go back and look at the development of the 1980 amendments to the nonforfeiture law, you will find that there is some language in there justifying that, on the grounds that, due to forward commitments and the use of private placements, a life insurance company typically did know six months in advance what rate it was going to be investing in, but I don't think that's true any longer, (assuming it was true then).

Some group products are currently exempt from CARVM. There is a proposed Guideline CCC that was meant to address that. That's been put on hold pending this new proposed valuation law.

Regarding long-term annuities, particularly structured annuities, which have benefits increasing 40 and 50 years after issue, you still have a reserve 30 years out that is at least as large as it was at issue.

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There was concern about the conservatism in the valuation rates that far out when presumably the assets would have rolled over by then. That has been addressed in Guideline 9B, and maybe it has been more than addressed, because a combination of Guideline 9B and the interest maintenance reserve, which came out a few years ago, may mean that reserves are now overly conservative.

Cliff surrender charges is another issue. The combination of curtate CARVM and the fact that you can use a fairly large differential between the valuation rate and your guaranteed credited rate can give you large negative surplus strain at the time a cliff surrender charge expires.

Finally, there was the issue of valuation rates. We currently have several different "plan types," and there is the question of issue-year basis versus change-of-fund basis. Are they still appropriate and is there some way to simplify them?

I mentioned that some of these have already been addressed, and in fact, you might raise a question, do we still need a new standard valuation law? Our task force met during this meeting, and we raised that question for what I hope is the last time, and we spent some time talking about whether we really need a new Standard Valuation Law. Several of these issues are fairly significant and are still outstanding like continuous CARVM and cliff surrender charges. Also, what should we do about long-term liabilities, variable insurance, and the lag in valuation rates? There are still quite a few things that need to be addressed. Our current plan is to revise the valuation law if we can.

So what were the recommendations that the 1994 technical resource group members made? Some of these are fairly easy to say. First, they wanted to cover group and variable contracts, bringing them into CARVM. The continuous versus curtate CARVM issue was easily settled. We decided to go with continuous CARVM. With regard to the Academy report in 1991, those authors talked about elective versus nonelective benefits and that perhaps elective benefits should be the only benefit types we apply greatest present values to. Nonelective benefits such as death would not follow the greatest present value approach. The 1994 report spoke about valuing a core benefit on a greatest present value basis and the core benefit that the report was pointing towards for your typical single premium deferred annuity (SPDA) product would be the cash surrender value. Everything else would have

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been handled using the utilization rates that the valuation actuary would choose. The Actuarial Task Force has told us that going to complete judgment by the actuary is going too far. The task force is willing to provide some discretion to the valuation actuary, but within parameters. There are some parameters within health insurance reserves, where the actuary has some choice in the matter, and Frank Dino has asked us to take a look at that. But the idea of just saying the actuary can choose annuitization utilization rates, based on what he or she thinks is best, is not something that's going to fly.

In fact, just going back to the basics, it was specified in 1992 when the group was set up and it was reiterated in 1995, that it is not yet our place to recommend a radical change to annuity valuation. The time has not yet come to switch to a method like Canada, for example, where the actuary is basically responsible for setting the reserve. Our job is to revise the current formula minimums, and maybe to some extent, with regard to utilization of minor benefits, we can allow some actuarial judgment.

The recommendation was that with regard to things like cliff surrender charges, that we have a maximum allowed spread between the assumed accumulation rate and the valuation rate, and it was suggested that 150 basis points would be the appropriate maximum spread to allow for SPDAs. Carrying that logic over to variables, that would say variable contracts would have a maximum spread equal to the asset charges. Interestingly, if the new nonforfeiture law goes through, and it gets applied to annuities as well as to life insurance, and you have a company plan, and that plan specifies what the company's interest margins are going to be, it would seem illogical to assume for valuation, future interest margins that are larger than what your company plan says you're going to have for nonforfeiture purposes. So these two laws may get intermingled.

Regarding noncash-value plans, there were some concerns about certain GICs and other individual deferred annuities with no cash surrender values that the reserve would be too low, if we simply look at annuitization benefits and discount them back. So we're still trying to address that, but we wanted to get up to an appropriate reserve for those kinds of products.

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And last, but certainly not least, was a proposed overhaul of the way we determine valuation rates. This is where the complexity comes in. I will give you an update of where we stand on valuation rates. It's proposed that valuation rates be set using something other than the Moody's Index, which is what the current valuation law is. The Moody's Index is approximately a 15-year average maturity bond portfolio, and it's kind of strange to be using a 15-year bond portfolio to value things like short-term contracts such as SPDAs and short-term GICs. On the other hand, we also use the Moody's Index to value very long-term liabilities, like structured settlements, although maybe the difference there isn't quite so bad. But we felt that the combination of the fact that it seems strange to use a 15-year average maturity index for valuing all kinds of maturity liability, and also the fact that the Moody's Index is a corporate bond index and companies don't necessarily invest only in corporate bonds, or maybe even not a majority in corporate bonds led the group to suggest that a better basis for valuation rates would be Treasury rates. So the basic concept was, if we have annuities that have certain cash flows at certain points in time, let's discount those back at valuation rates based on Treasury spot rates.

For certain fixed annuities, where the payments are certain, we can do that fairly directly. For other annuities, like SPDAs, where the cash flows are less certain, we have to apply a little bit of judgment. Our current thinking now is that for something like SPDAs, we would probably look at the three-year spot rate as our basis for valuation. For some kind of annuities, like modified guaranteed annuities and bullet GICs, it would make more sense, though, to look at the maturity date of those annuities and let that maturity date be the spot rate that we base the valuation rates on. For structured settlement annuities, we can go all the way out to 30 years, at least for 30 years of payments, and then we have to decide what to do about payments at the end, or payments beyond year 30.

The formula that was proposed in 1994 was 105% of the Treasury rate, plus 25 basis points for cash flows that would be occurring for the first 15 years. Then that was graded down to 100% of Treasury for cash flows by the end of year 30. Beyond year 30, it was felt that the discounting should be done using a conservative long-term rate, and both 4% and 5% have been discussed.

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Now how do we address the lag factor in the valuation rate? Keep in mind we use a 12-month average ending in June, so we don't know until June what our valuation rate is going to be, but on the other hand, it's also really six months off, and the last couple of years, I think, have shown us that being six months off can have quite an effect. The 1994 report suggested two company options. One is, we would just flat out reduce the lag. We would have a single rate for the calendar year issues, but we would determine that rate in November. So it would be a 12-month average ending in October. So we have a two-month lag instead of a six-month lag. At least it's better with regard to the lag point of view, but now we don't know for ten months or even eleven months what valuation rate we're going to have. So it's worse from that point of view.

One way to get around that would be to have a company option to use monthly valuation rates. So each month, you would use a different valuation rate for that month's issues. This could get complex. We haven't yet finalized just what day of the month we're going to fix this rate. It has been mentioned that sometimes funny things happen on the last day of the month, with regard to Treasury rates, especially the last day of the quarter. And maybe we should use the first day of the month. Or maybe we should use the monthly average. We're still kind of working out the details, but I think you get the idea of what's going on. We're also thinking about the fact that maybe, when you get to the end of the month, you have 12-month issues, valued at 12 different sets of valuation rates. Wouldn't it be nice if we could calculate a single average rate that would replicate the initial reserve, and then our valuation system would have fewer tables on it. So we're playing with that idea. That seems to be fairly workable for things like structured settlement annuities. I think we can do that. For other kinds of liabilities, maybe that won't work.

Another thing we want to do that adds a second layer of complexity is to refresh the valuation rates over time. This is significant for both short-term annuities and long-term annuities. Let's think of SPDAs. Right now you issue an SPDA and get a valuation interest rate. It's locked in at issue. It's there for all time. And yet everybody knows that the assets are rolling over fairly quickly, and you're probably declaring or guaranteeing a new rate for the next year that's based on either the rollover of your assets, if you're on a portfolio basis, or on some market yield, if you're using a competitor rate index as your crediting strategy. It would seem like there ought to be some rollover on valuation

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rates for SPDAs. For modified guaranteed annuities, it's even more obvious. You have a five-year modified guaranteed annuity, the idea is you lock in a rate for five years, and everything rolls over at the end of five years. Shouldn't you have a rollover on your valuation rate at the same time?

Well, we've fussed about this issue for quite a while and tried to determine that for something like SPDAs, we can't come up with a formula as to how these rates ought to roll over because we don't know. It's either super complex or inappropriate for certain kinds of annuities because it's going to depend upon your surrender charge scale, the way you credit interest rates and so on. So our current thinking is that we will have the actuary file a plan. We're going to allow an option not to refresh, although we'll probably make it so punitive you might not want to accept that option. But we will allow the company to file a plan for how it would refresh or rollover its valuation rates on a plan, and the plan would have to be on some unbiased basis. You can't just do a ratchet type. For example, when valuation rates go up, you chose to rollover your rates, otherwise you won't. I think that's something where an actuarial guideline will be needed to provide support.

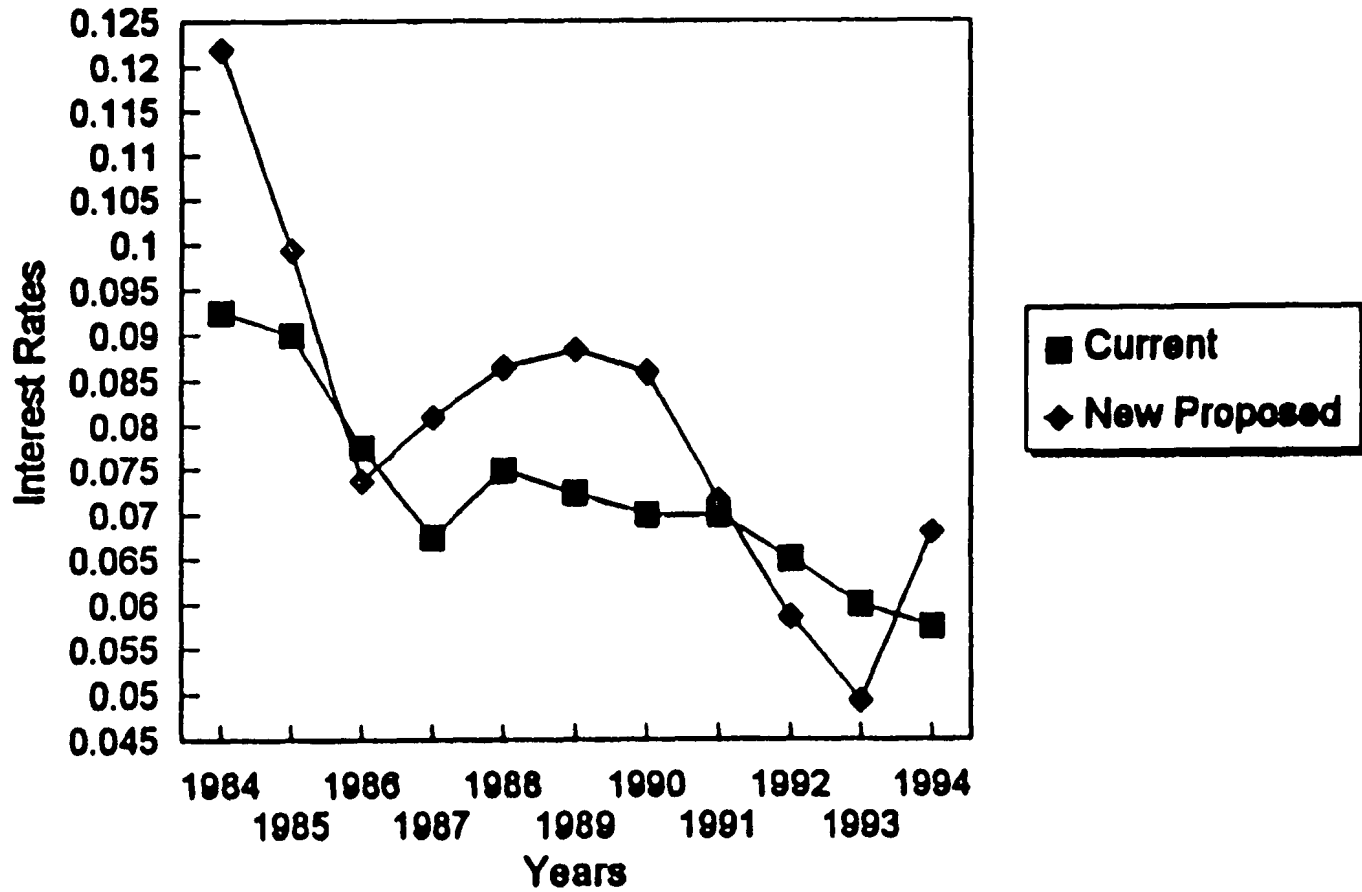
Let's discuss structured settlement annuities with very long-term liabilities. Right now we think at issue we would have a valuation rate that's based on market rates for the first 30 years, but thereafter, we would have something much lower. That would seem like something where we should also allow the ability, if interest rates stay high to refresh those valuation rates and get some credit for that. Still, there is somewhat of a question as to just how significant that is and whether it's worthwhile, but we think it's worthwhile in some circumstances, so we want to allow for that.

I'd like to share some sample valuation rates. Keep in mind this is just tentative at this time. The basis for what's called the new proposed rate is Treasury plus 50 basis points for 15 years, Treasury plus 25 basis points for the next 15 years, and 5% thereafter, although thereafter really doesn't count for most of these examples.

This is for various calendar years of issue going all the way back from 1984 through 1994, what the valuation rates would be. Chart 1 is for SPDAs and flexible premium deferred annuities (FPDAs). Three things I'd like to note. First, you can see the divergence of the two rates in 1993 and 1994. The

CHART 1

Compare Current to New Interest Rates
Product 1 -- SPDA and FPDA



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proposed rate falls much faster in 1993 and rises much faster in 1994. That's the six-month lag in effect. The proposed rate would eliminate that six-month lag, and we would follow the rates for that calendar year much more closely. Second, you might notice the new proposed rates seem to be more volatile. When they decrease, they seem to decrease faster. When they increase, they increase faster. That's because the current valuation rate is somewhat dampened: 3% plus some weighting factor times the excess of the Moody's Index over 3%, and that weighting factor tends to dampen the valuation rate. Whereas, we basically have 100% applied to the Index, as a weighting factor.

The third thing to notice is that the new proposed valuation rate averages about 80 basis points higher than what the current law has. But keep in mind, the current law is set up to be a lifetime valuation rate, and it's our plan that this valuation rate would only apply for a short period of time, but then it would be refreshed. So if rates were to fall, then the valuation would fall in the future.

I have three charts that show immediate annuity valuation rates. Chart 2 is for a single premium immediate annuity, level payments beginning at age 65, and we still have the discontinuity in 1993 and 1994 as a result of the lag. But I guess the conclusion from this is that at least this set of valuation rates follows the current valuation law. Chart 3 is for a single premium immediate annuity for age 35, with benefits increasing 3% a year, so more benefits are shoved out into later durations. But it still seems to follow reasonably close.

Chart 4 is for a single premium immediate annuity, issue age 50, but deferred payments until age 65. And here, we have the proposed valuation rates significantly higher than the current valuation law. That averages about 120 basis points higher, and the reason for that is there's a great deal of conservatism in the current valuation law for deferred annuities with deferred payments. The concern was the reinvestment risk. We need to do additional demonstration that, with certain kinds of assets, these valuation rates are supportable. But we think that's a real effect that the new valuation rates will have.

Chart 5 is a five-year GIC and Chart 6 switches to a 20-year GIC. We have the Plan Types A, B, and C. Basically, most GICs are probably valued using Plan Types A and B. So what we would have on

CHART 2

Compare Current to New Interest Rates
Product 2b -- Single Premium Annuity, Level Benefits at Age 65

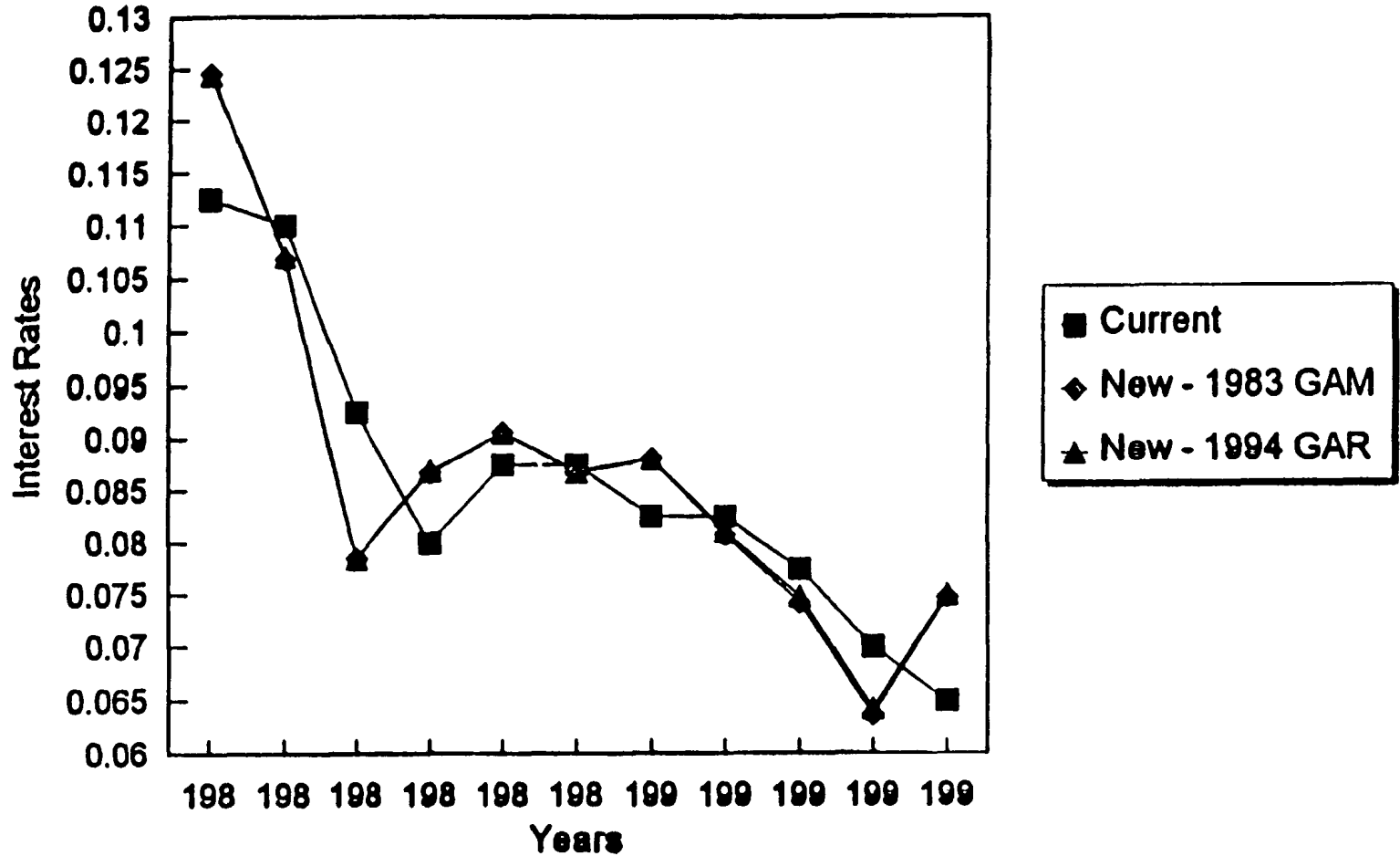


CHART 3

Compare Current to New Interest Rates
Product 2c -- Single Premium Annuity, Benefits Increasing at 3% at Age 35

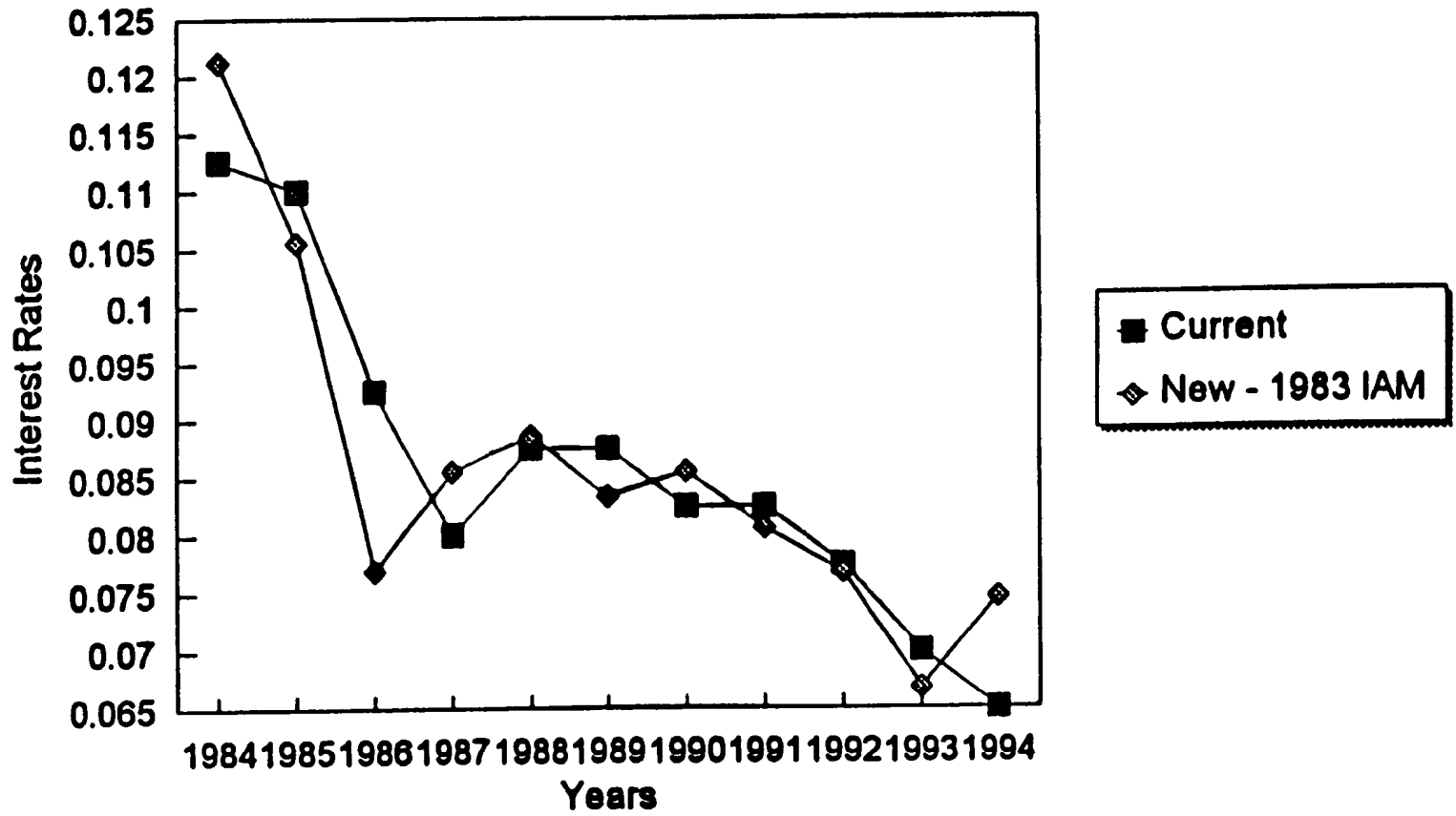


CHART 5

Interest Rates under Current and new Proposed
Product 3a -- Five-Year GIC

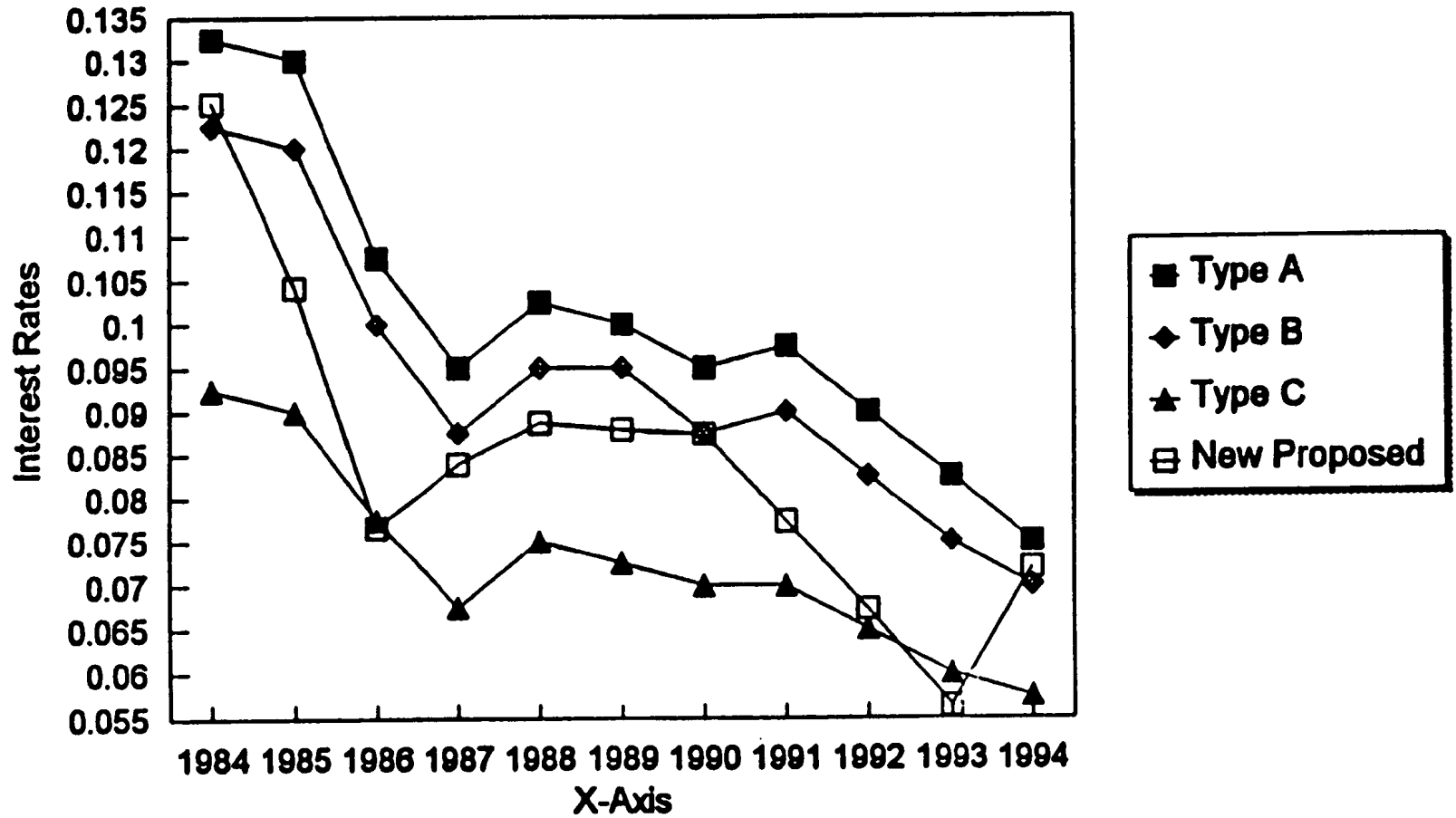
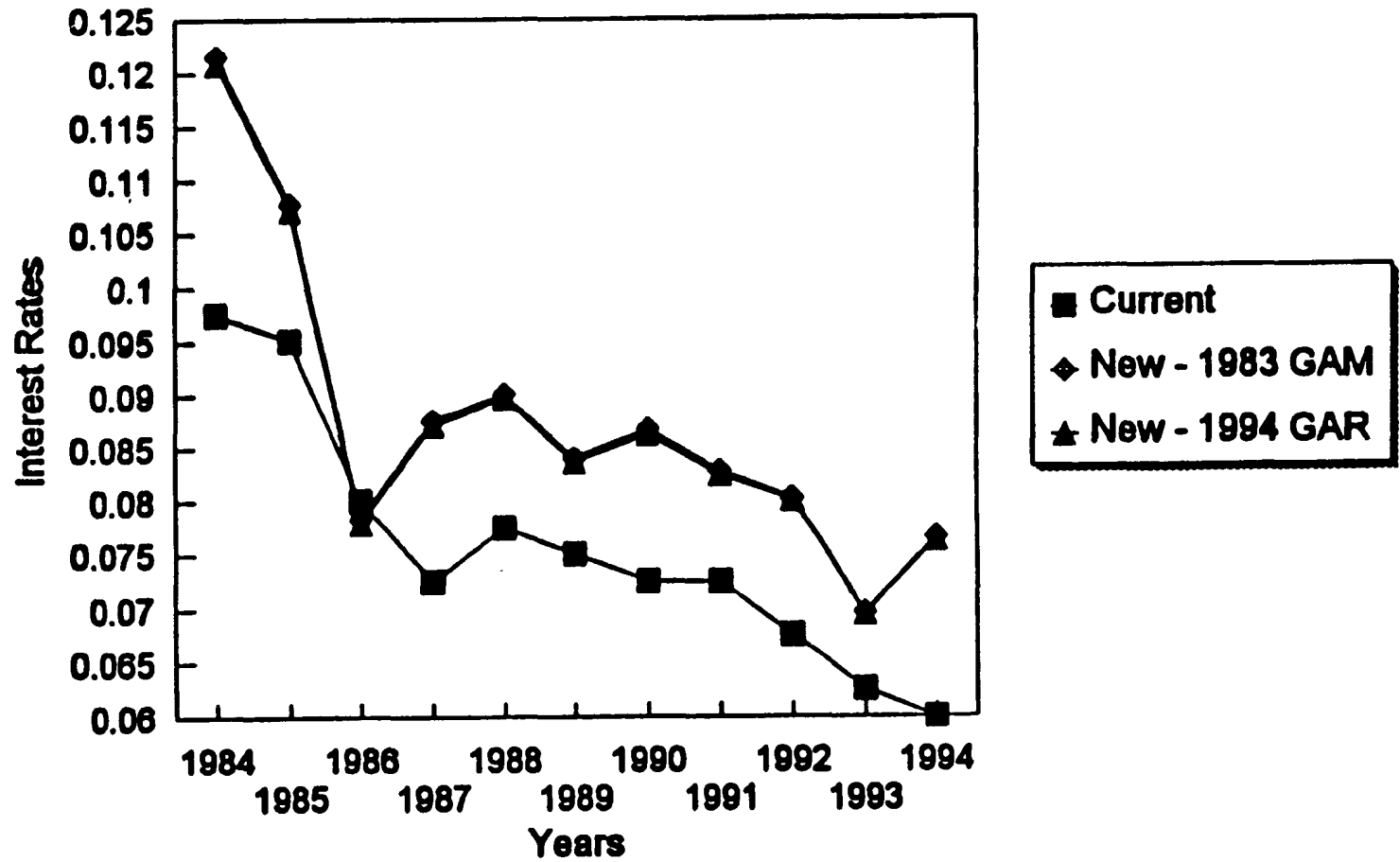


CHART 4

Compare Current to New Interest Rates
Product 2d -- Single Premium Annuity, Age 50, Deferred Benefits at Age 65



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a five-year GIC is lower valuation rate, under this proposal. And the reason for that is because we'd be basing this on a five-year Treasury rate, and because of the normal positive slope of the yield curve, that's going to give us lower rates than the current valuation basis, which looks to the Moody's Index. But if we look to the 20-year GIC in Chart 6, we can see that the valuation rate then gets back up to where the current valuation law is for those Plan Types A and B.

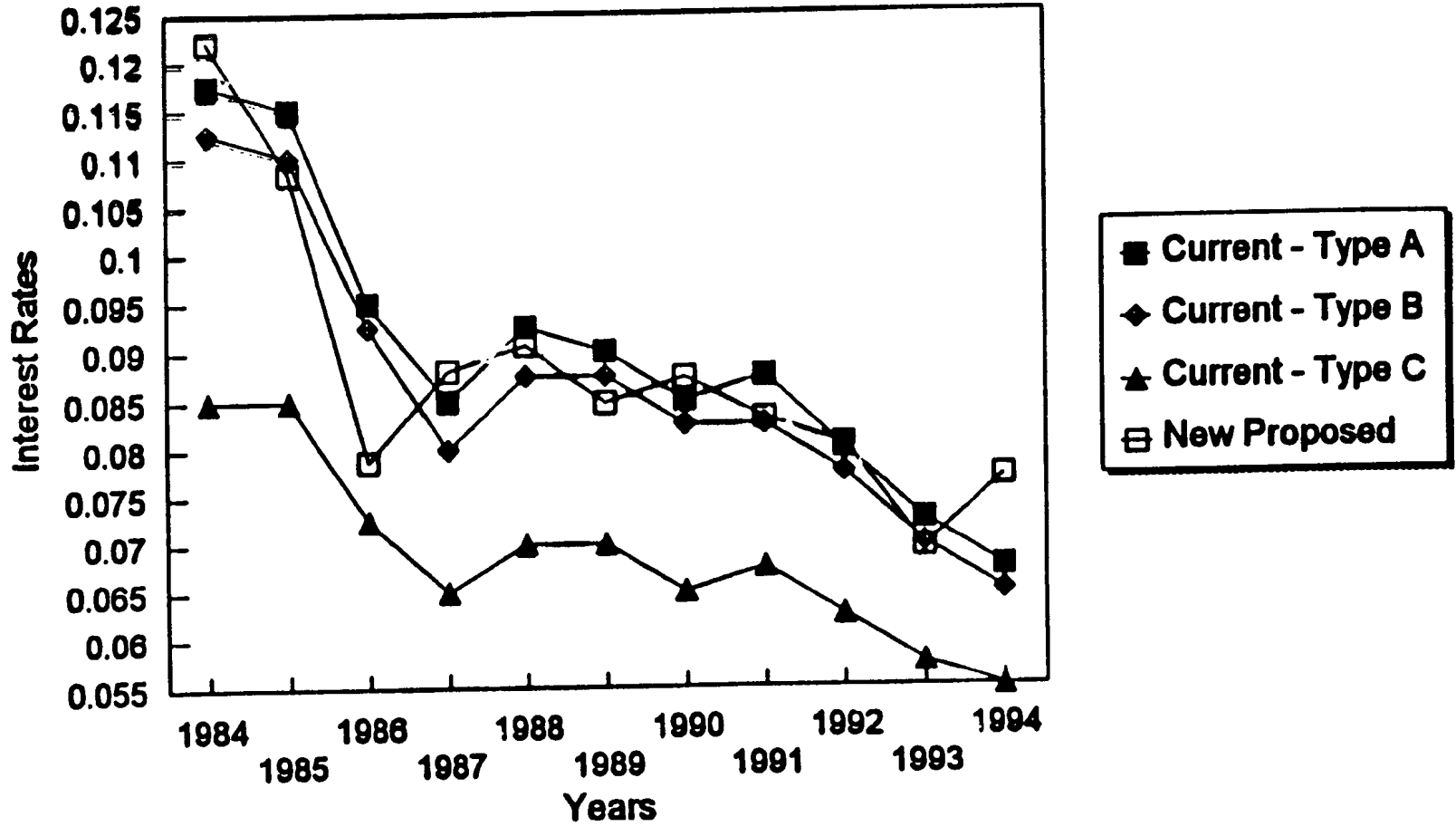
I will now update you as to what we've done in 1995 versus the 1994 report. The 1994 report thought that there would be a core benefit that would just be cash surrender value, but we really believe that CARVM should also cover the annuitization options. This is particularly so if you have an annuitization option that is less than ten years. The five-year certain annuity is just another way to cash out a policy. So the greatest present-value calculations ought to cover that.

There is some thinking, though, that perhaps for lifetime annuitizations, we could apply utilization assumptions, because there are considerations that go into taking a lifetime annuity that go beyond just trying to select against the life company. Obviously, we're not going to have utilization assumptions for cash value. We're probably getting away largely from utilization assumptions on annuitization. For some things, like nursing home waivers and surrender charges, we're going to have standard tables. We think there are some areas in which actuarial judgment can be used. One of the areas that we've been looking at is pension buy-out business and assumptions for retirement rates. That's basically something that you have to consider on an individual case-by-case basis. We think there's room there for actuarial judgment on choosing those assumptions.

Let's discuss simplification of valuation rates. If anybody has an idea of how we can have a valuation rate that will actually fit the rates in effect for a calendar year and fit the distribution of business issued during the year, and not involve monthly valuation rates, I'd like to hear it. We talked about using Treasury spot rates, and we are going to simplify that. We're not going to require each and every one of your annuities to project out the cash flows and use 30 years of spot rates for the valuation, but that's the ideal that we would have and now we're going to bring it down to a practical level.

CHART 6

Compare Current to New Interest Rates
Product 3b -- 20-Year GICs



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MR. RAYMOND: I'm going to talk about three things: basic reserves for variable products; minimum death benefit guarantees on variable annuities; and some of the separate account surplus issues.

Reserving for variable products has been an issue on and off for about the past ten years. The first time that it was really focused on was about ten years ago, as a result of the 1984 tax law change. What is the minimum reserve standard for variable products? As we go through this, I'm going to focus my comments mostly from an annuity point of view, but you can take a lot of the concepts in a broader context. (It really does apply to both variable life and annuity, although most of the discussion has focused on variable annuities.)

When you look at the law and the regulations, it's clear that CARVM does not apply to a variable product. The model variable law and regulations basically say that reserves are to be calculated, recognizing the variable nature of the product, and consistent with the methodologies defined in the appropriate section, which defines CARVM or CRVM. The appropriate methodology became an issue when the tax law changed, because we needed to know what the minimum reserve standard was, and there apparently wasn't a clear one. It also became a larger issue as we moved into the 1990s, companies became a lot more focused on capital, and the growth of variable products continued at a much higher pace.

A few years ago, attention was focused again on this issue, by a proposal made at the NAIC for another one of these three-letter guidelines. Guideline VVV initially caught everybody's attention because it was a proposal to require reserves at full account value. There was a lot of discussion for about a six- to nine-month period at the NAIC. Eventually the guideline was set aside, although the issue as to what appropriate reserves are for variable products remains an active issue at the NAIC. In the past year or so, with the growth of separate accounts and some of the focus on separate account issues in general, the reserving issues on variable products has also been revived at the NAIC.

Currently, practice remains varied as to how companies calculate reserves for variable products. For variable annuities, the Society of Actuaries recently did a survey of variable annuity writers. The

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survey shows a range of practice in the industry from just holding cash surrender values, to holding full account value, to holding what is referred to as CARVM. The majority of companies seem to be holding what they feel is a CARVM-type reserve. The most common interpretation that companies take as to what a CARVM-type reserve is described in the American Academy of Actuaries white paper on CARVM that Doug referred to earlier. Also note, as Doug mentioned, his group has been charged with broadening the definition of CARVM to include variable annuities.

When applying a CARVM-type calculation to a variable annuity, the biggest question is, how do you determine what the guaranteed stream of future benefits is that you're going to value? I remember being involved in some conversations about ten years ago, where it was argued that, on a variable product (because you essentially have guaranteed nothing), the only guaranteed benefit is today's cash surrender value. I think that position may still be held by certain people. The more accepted general approach is that what has been guaranteed is that there's a consistency between the rate that's earned by the company and the rate that is credited to the policyholder. So the stream of benefits needs to be defined that's consistent with the discount rate that's being utilized. It's essentially that spread that has been guaranteed by the contract.

In applying this approach, the discount rate is normally determined first, and then a credited rate is determined that is consistent with the discount rate. This sounds fairly simple, but determining which discount rate and what spread you use leaves a lot of room for interpretation. It's also an issue that has varied opinions today among company actuaries and regulators.

The Academy white paper recommended that the discount rate utilized be the Type A discount rate, essentially, looking at the rate that would be appropriate if this were a general account product. The choice of the appropriate discount rate is complicated a little bit when the impact of this rate under various product designs is analyzed. Under a number of product designs as we raise the valuation rates up, the reserve actually goes up, which seems a little counterintuitive. We normally assume that higher valuation rate will result in a lower reserve. I won't get into why that happens, but if you think about it, and do a couple of examples, I'm sure you'll see that under a great deal of product designs

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this will happen. So it does bear some serious thought as far as whether the interest assumption that you may feel is conservative in calculating the reserve really is or not.

Determining the spread is the other issue. The Academy's white paper recommended that the projection be based on a spread that reflects the charges in the underlying contract. Often in practice, this means utilizing the mortality & expense (M&E) charge in the contract as the spread. Essentially then benefits are projected forward at the discount rate less the M&E charge. Arguments can also be made for including other administrative charges that may be in the contract, as well as fund level charges that may accrue to the benefits of the company. Fund level charges, if they are included, are normally net of investment expenses, consistent with the way we normally do valuation.

An issue that's often raised relative to this is whether or not expenses should be netted out of that calculation; the argument goes since you're essentially taking all your charges, you need to make provision for your normal policy administrative fees. My reaction to this is there are normally additional charges specifically for expenses that are often ignored in the projection. Additionally, in defining the minimum reserve standard, the actual expenses or administrative expenses, are never a portion of our basic reserve standards. Therefore, it is inappropriate to reflect actual expenses in the reserve standard. The minimum reserve should be calculated based on the basic methodology without providing for expenses even when we look at deficiency reserves. We don't provide for expenses. But clearly, it's necessary to look at the reserve after it is calculated under a reasonable set of assumptions, to determine whether that reserve is adequate in aggregate. This analysis should include maintenance expenses.

Let's go on to minimum guaranteed death benefits. Where did this issue come from? Over the past few years, minimum death benefits have expanded greatly on variable annuities. Competition, the growth of the products, the desire for companies to focus on persistency on these policies has led to a wide growth in benefits and an increase in the value of the minimum death benefits added to variable annuities. That obviously has raised a concern as to whether these benefits are appropriately reflected in valuation. There's really no clear guidance as to how to calculate reserves for these benefits in existing law and regulation. There is a fairly detailed explanation of how to calculate reserves for

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variable life guaranteed minimum death benefits, but there really is very little guidance as to how to calculate them for an annuity.

In fall 1994, the attention was focused on this issue when Connecticut sent out a letter to all Connecticut domiciled companies expressing its position on this subject. The connective position was a very conservative approach to valuation of the reserve, or at least it was felt to be very conservative by most of us.

In addition, New York is looking closely at the issue. The NAIC has established a separate account working group that's looking at a wide range of separate account issues, both valuation issues as well as surplus issues in the separate account. New York had this on its agenda for 1995 to address the issue of whether additional benefits were being added on variable annuities that were not being appropriately reflected in reserving and how New York should handle them. I made a presentation to the NAIC group at their January 1995 meeting, and as a result of my presentation, the Academy was asked to prepare a proposed guideline for the NAIC to consider, to clarify reserve methods on these benefits.

The Academy then requested some assistance from the Society of Actuaries in researching the appropriate methodologies and industry practices. As a matter of fact, the Society had already had that process underway. The Society group was chaired by Bob Johanson and Steve Preston. They've done a good deal of their work. The survey I referred to earlier was part of their work.

In addition, the Academy has started work on a draft guideline. That group is chaired by Steve Preston and Tom Campbell. They presented a preliminary proposal to the NAIC separate account working group, and they are working on getting a draft report out. What I'd like to do is give you a little sneak preview of some of the things that they're looking at in the draft report.

As Doug mentioned earlier, one of the issues that was discussed at the Life/Health Actuarial Task Force at the NAIC recently was the interpretation of the appropriate methodology for integration of death benefit type benefits with your basic reserve calculation. That issue and some of the

clarification that was received, as far as the view of the NAIC of certain regulators on that issue is being considered by this group. The work to date has been primarily focused on looking at the conceptual methodology for calculating a reserve, looking at this benefit on its own. They are then going to be looking at how that should be integrated with the basic CARVM calculation. The general practice has been to calculate either a retrospective or prospective reserve or both, and hold some kind of a combination of it. The group members have been looking at all those possibilities and mapping out what they believe to be a recommended and appropriate methodology for doing both the retrospective and prospective, and then they will be refining this to define the actual reserve they feel should be held. The recommendation right now looks at each of the pieces.

These are their preliminary conclusions, and this has not yet been finalized. Preliminarily, on prospective basis, we should be looking at a one-year term reserve. Essentially, the thought is that the minimum reserve ensures that we set aside enough money to provide for a wide range of contingencies within the next year before the next annual statement.

The appropriate mortality table has been one of the major points of contention. The group at this point is leaning towards a conservative annuity-based mortality assumption. There has been some discussion as to whether it should be annuity or life-based, considering the way these products are generally sold, and also considering the consistency with the underlying annuity valuation. The group appropriately is leaning towards a conservative annuity-based mortality table.

The other major issue, and this also is reflected in the variable life minimum death benefit reserve requirement, is that the cost to these benefits is generally very heavily related to the volatility of the benefit. Since you're guaranteeing the minimum level, obviously, if the account value drops, which can happen in a variable contract, then the cost of that death benefit increases drastically. How that should be reflected in the reserve calculation is a very large point of contention. On the variable life side, there's an immediate one-third drop assumed and then a growth from that point. Most of us feel that the one-third drop is a very arbitrary and overly conservative number, particularly considering the wide range of separate accounts that exist. And also, when you look at a variable annuity, the

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death benefit is much less significant than it is relative to the valuation on a life policy, and the impact of the one-third drop on reserving can be more significant than on a life policy.

The group's recommendation is that the drop that's used in the valuation be based on looking at the risk characteristics of the underlying accounts, and the group is in the process of trying to refine the methodology that can standardize how that's calculated. Standardization is necessary because everybody trying to determine what the risk characteristics of every separate account is. I think that is a difficult issue. Once the report is finalized and released, you'll find that the group has done a lot of good work on finding a balance between getting the right answer and getting something that's not overly complicated and easy to audit.

From a retrospective basis, the retrospective reserve is an accumulation of some type of annual contributions. The normal thought on this is that you're effectively funding this reserve out of M&E charges or some other charges to the account. We should be holding some kind of a level premium type reserve off those M&E charges over the life of the policy less actual claims, rather than tabular claims. It is fairly common practice in the industry right now to reflect actual claims on this.

A fairly innovative approach that's being suggested by the group is that this net premium be determined by looking at the risk characteristics of a product, the structure of the benefit itself, and some degree of stochastic testing be used to determine the actual cost of the benefits to determine the net premium. I think this is similar to some of the things that Doug was talking about as far as some of the valuation issues. We must take a step forward and start to be bit more flexible as far as assumptions and reliance on the actuary to make some rational decisions, about how to value the benefits.

Again, the fine point here is how to bring this type of valuation in, which makes a lot of sense. The only way to avoid having an overly conservative reserve is to get to this type of valuation, but you must do it in a way that's not overly work intensive and does not create an impossibility as far as an audit trail and for a regulator to review. This is very important and the group members have been putting a lot of effort into it. They are working very closely, not just among themselves, but also with

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regulators and other company people on this issue. Once they finalize the recommendations, I am certain that you'll find they've done a good job on this difficult issue.

Then of course, the next issue is the combination of the retrospective and prospective: whether it's the greater of the two, or whether you have one trending into the other. Then integration of this reserve with the basic reserve on the policy must be examined.

I'd like to touch on another major issue of the NAIC separate account working group, separate account surplus. As we talk about reserves on variable products, I should mention that the result of having CARVM type reserves on variable products is that you often have reserves that are less than the policy account value. What follows from this is there is surplus in a separate account or something that looks like surplus in a separate account. The difference between the account value and the CARVM-type reserve has raised a lot of questions and a lot of misunderstanding as to what it is and how it should be accounted for.

The NAIC separate account working group has been looking at this issue and has been working with the Life/Health Actuarial Task Force to try to determine its appropriateness. The first question the members asked was, we have surplus here that's sitting in a separate account and, is it real? After a good deal of discussion on this topic, the general reaction of that group has been that the actual question is not whether the surplus is real or not, but is the reserve appropriate? Once you've determined that the reserve is appropriate, and if there is surplus left in there, then that's real surplus.

To determine the appropriateness of the reserve, one of the issues that needs to be dealt with is how do you actually calculate the reserve? The NAIC, at this point, is waiting for the results of Doug's group to move forward on clarifying, on a going-forward basis what the appropriate reserves are for these products.

In addition, it needs to be clarified (I think Larry Gorski in his Halloween 1994 letter to companies in Illinois clarified this from his point of view) that asset adequacy analysis needs to be done including

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separate accounts in order for the actuary doing the opinion to verify that the reserves in the separate account are adequate and appropriate.

The other question the working group members have dealt with is, can I find this and where is it in the statement? They have issued a decision at their summer 1995 meeting to require a common methodology for accounting for separate account surplus. Essentially this requires a negative liability to be booked in the general account. The negative liability is a transfer due from the separate account. The separate account statement then does not show a surplus amount. It shows an amount due to the general account, there is a corresponding negative liability in the general account. The result is net on the company's books; the total amount of surplus is correct. From the NAIC's point of view, this provides consistency; regulators know where this number is, and they know how to deal with it.

The NAIC has decided how this surplus will be reported; the next issue they are addressing is whether the risk-based capital calculation is appropriately handling it.

MR. SELIG EHRLICH: I know there are a lot of sessions later on the specifics of GGG, so I won't ask about that. I am curious though about the process. Various things were debated, as you said, for a long time. Should the benefits be looked at separately; should they be looked at in combination? Should we have utilization? Something was published and was adopted, and now I'm hearing, "we're going to do a mixed approach, that's what we really meant," even though it says something else. As a practitioner, I'm getting a little bit confused. How do we figure out what actuaries, who have to meet this guideline, are supposed to do and whether or not there has been a check and balance if, in fact, it's not going through a state adoption process.

MR. DOLL: The NAIC did have an exposure process. It doesn't adopt these guidelines in a vacuum. As far as the NAIC adopting the mixed benefit thing and whether or not that conflicts with the guideline that's published, I guess you can argue about that, but you can look at the wording and come to an interpretation that the mixed benefit is one of the benefit streams.

MR. FRANK P. DINO: With respect to Guideline GGG, as everyone knows, these are very intricate types of products, and there is not one answer that fits all. The guideline was an attempt to add some more clarity to the CARVM law where we found significant issues raised and abuses. It is not an all-saving answer. We did approach it from the different components to clearly say that these need to be valued. The text of the document actually says, "all possible benefit streams." It was not limited to a single type of benefit occurrence. The subparagraph beyond that gave clarity on these types of benefits, how to get a valuation interest rate. The guideline is then silent on the mixing of benefits, and the real question that it's silent on is, if you mix benefits in one stream, what is the interest rate? And that is what was being discussed at the last Life/Health Actuarial Task Force meeting. I believe that split interest would also be appropriate, in that one benefit stream, based on the different benefit pieces. If it is believed to be truly necessary for additional clarity, a group could look at a proposal and recommend some modifications and changes to the document, and we could reopen it and readopt it. It would not be considered a very high priority right now, but we would entertain that if a group thinks that it's necessary.

MR. EHRLICH: I'm afraid I'm going to have to go back and read it again, because I thought there was a specific statement in there that each benefit is supposed to be valued independently and with an assumed 100% utilization. But if it isn't that clear, I'll stand corrected.

MR. ROBERT H. DREYER: Presumably under the new nonforfeiture proposal, if you do have a product that eliminates a cash surrender value, you can also eliminate the policy loan provision.

MR. DOLL: Policy loans were discussed, and it was concluded that that's an issue that needs to be addressed.

MR. DREYER: Well, I respectfully suggest that, if you have a policy loan, you have a cash surrender value.

MR. DOLL: That would make some sense.

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MR. CHARLES D. FRIEDSTAT: To what extent has the annuity valuation working group considered federal income tax consequences of some of these reserving proposals? It appears that some of these valuation techniques would involve significant federal income tax implications. It's my opinion that too often in the process of coming up with these guidelines, federal income taxes are either ignored or considered at the tail end of finalizing the guidelines.

MR. DOLL: Federal income tax is discussed constantly. Particularly when we start getting into things like options, as in an option to value something one way or the other. The concern is that the IRS will then require you to use the option that provides the lower value. We're not at the point of bringing in tax counsel to look at the point, but we haven't forgotten tax issues. We're trying not to let tax issues drive the process.