1996 VALUATION ACTUARY
SYMPOSIUM PROCEEDINGS

SESSION 26

State Variations from Standard Law

J. Peter Duran, Moderator

Thomas A. Campbell

Wm. Harold Phillips

Shirley Hwei-Chung Shao

James N. Van Elsen

STATE VARIATIONS FROM STANDARD LAW

MR. J. PETER DURAN: I am the moderator for this presentation, and I am an actuary with Ernst and Young in New York City. We have a very distinguished panel.

Harold Phillips is a senior life actuary with the California Department of Insurance. He has been with the California Department for eight years and has previously worked in the industry. He reviews legislation and develops regulations on valuation requirements and actuarial memoranda for the California Department. Harold is going to talk about the origin of the problem of state variations in valuation laws and is going to suggest his own approach to resolve the problem. This approach may not be representative of the official view.

Shirley Shao is a vice president and assistant actuary in the corporate risk management department of the Prudential Insurance Company. She is the chair of the American Academy of Actuaries task force on state variations in valuation laws and is going to talk to us about the challenges of state variations from a large company perspective. Specifically, Shirley will talk about issues that many of us will be facing in preparing the 1996 annual statement as well as her task force's proposal for a solution to the problem. Shirley will share her presentation with Tom Campbell. Tom is an actuary with Hartford Life Insurance Company.

Finally, Jim Van Elsen is an independent consultant and a member of the Small Company Section Council. Jim is going to give us the point of view of the small companies and will share with us why he believes that some of the suggested solutions may not be appropriate for the smaller companies.

MR. WM. HAROLD PHILLIPS: I am going to share with you my own thoughts. These may not be representative of the California Insurance Department's official position.

Why do we have state variations? In the United States we have allowed reserves, certain admitted assets, and some accounting practices to be subject to the political processes of the 50 states. For example, on the asset side, the variations include accounting for home office properties, furniture, computer equipment, and so on. On the reserve side, the problem of having to satisfy the reserve requirements of the state of domicile and the state of filing has been with us since 1942. The Actuarial Opinion and Memorandum Regulation simply forced the issue by a literal reading of the Standard Valuation law. With fewer products back then, state variations in reserves were minor, well known, and easily resolved.

With the proliferation of new products such as universal life, flexible premium annuities, modified guaranteed annuities, separate account guaranteed investment contracts (GICs), synthetic GICs, two-tier annuities, two-tier life insurance and, most recently, equity-indexed annuities, state variations are inevitable with 50 independent states reviewing the reserve bases especially where the NAIC has not taken an authoritative position.

To define the state variations, we must first gather and define all the NAIC model guidelines and interpretations for all lines of business. Second, we need to gather and define a state's position in all these lines.

It is hard to find in each state a person who is knowledgeable in all of the above. Even if one is aware of all the NAIC models and guidelines, variations can occur. The date of adoption of NAIC model regulations can vary widely. Also, a state adopts a particular version of the model that exists on the adoption date as the NAIC tends to fine tune its models. For example, I have worked on a health reserve model regulation. There were many changes as a result of improvements in the NAIC model. However, once we adopt a model regulation, it is unlikely changes will be made because of the lack of resources at the state insurance department.

Each state will interpret the model as it sees fit, and such interpretation may differ from those of other states. A state may disagree with the NAIC model and go its own way, or it may have addressed the issue before the NAIC and chooses not to change. An example is the interest assumption on universal life reserves in California.

California adopted the NAIC model regulation for modified guaranteed annuities and also issued bulletins covering reserves and blank reporting. This practice may differ from other states, such as New York. California also has special legislation and bulletins for separate account GICs and synthetic GICs. This way the state does not have to go through many months of legal work including hearings on proposed regulations.

In California, bulletins have the force of regulations, if the statute so states. In our bulletins, we address the reserve and reporting issues as best we see fit. We are not aware of what the NAIC or the other states are doing in this regard, so state variations can arise.

Another example of state variations is Regulation XXX. Historically companies were holding reserves on a unitary basis. Roy Olson of the Washington Department objected to this practice and believed there should be segmentation. This was the impetus for the appointment of the group that addressed the issue leading to the XXX recommendation which was finally adopted. However this issue was really resolved in the 1940s by the NAIC when the Hooker Committee suggested this segmentation method and it was adopted. California Bulletin 74-11 simply reiterated the point, as did Guideline IV adopted by the NAIC in December 1984.

For business before January 1, 1997, California will accept reserves based on Bulletin 74-11 or any basis based on an interpretation of the Standard Valuation Law (SVL) supported by a gross premium valuation. For business on January 1, 1997 and later, Regulation XXX will be a permitted basis of valuation, though it is not required. If a basis other than XXX is used, the reserve must be tested by a gross premium valuation, recognizing lapses, much higher mortality on those who convert, renew, or don't lapse. Gross premium valuation is an important aspect of asset adequacy analysis. California is working with an Academy group to finalize our bulletin on this matter.

We do not believe the NAIC or anyone else has properly addressed reserve issues for variable annuities. I do not believe that the commissioner's annuity reserve valuation method (CARVM) applies because one cannot take the greatest present value of an undefined benefit. Our main concern is the adequacy of margins to build the cash value to the account value if the cash value is held as a reserve. Thus, the reserves should be the account value or less, but not less than cash value, if justified by cash-flow testing. This testing is not to test the impact of various interest rate scenarios. Companies often say they do not perform any asset adequacy analysis because C-3 risk is borne by the policyholder. However, the state is still concerned about the adequacy of margins.

There are many problems caused by state variations. An actuary must now understand GAAP reporting and reserving, tax reserving and accounting in addition to statutory reserving with possible variations. Assuming the state variations are known, definable, and measurable, there are a number of choices. One may hold the highest reserves required anywhere for every state. Alternatively, one may hold the higher reserves only in the states requiring them, or file one statement assuming no extra territorial effect. One may also choose to meet the requirements of only the state of domicile.

My personal view is that the cost of complying with state variations imposes an unreasonable burden on the companies and the industry. In an increasingly competitive financial services industry, this extra burden will strengthen competitors who do not have this cost, placing an unfair disadvantage on the industry and the customers who must bear it.

Getting a prompt, authoritative and trustworthy definition of the proper reserve basis for new products is another difficulty with state variations. Many companies introduce new products and give reserving their best attempt. After a few years of reserve buildup, the authorities decide on a newly defined method which may require much larger reserves than the companies have planned for in pricing. Surplus takes a big hit as a result. An example is the two-tiered annuities addressed by Guideline 33.

The NAIC is attempting to codify statutory accounting through the codification project. The attempt is to make statutory accounting on the other comprehensive basis of accounting (OCBOA) project.

This project presumes to include reserves which shall be in accordance with NAIC standards. Variations will be permitted if disclosed.

In a memo called "Reserving Standards for California and the United States," I proposed we develop and adopt an NAIC reserve valuation of policy and contract liabilities manual or another chapter in the accounting manual. This would be the authoritative source of reserve standards in the United States. It would contain the Standard Valuation Law, models involving reserves and the Actuarial Guidelines, which would be the authoritative interpretations. Each state would have to comply with these standards. We should have a nationally uniform method and basis for reserving as we do for the valuation of assets. Cash-flow testing would be on the basis of one set of reserves and not on variations. It now requires 26 states to adopt a reserve standard. The new system would bring it in all at the same time.

The development of this proposed manual or new chapter in the accounting manual would create tremendous efficiency for the states as the time and effort in adopting a model in 50 states is horrendous. The actuarial opinion would be changed to an opinion that the reserves meet the standards in the NAIC manual. Companies developing new products will be able to go to the NAIC and get an official position on reserving. The states would still retain control through the working of the NAIC.

Another solution to the problem of state variations is to simply accept the standard for the home state. This would make life a lot easier for companies and actuaries, but would still result in variations in financial reporting.

One impetus to develop GAAP for mutuals and fraternals is the need for one national standard. The accounting profession and the Securities and Exchange Commission (SEC) have great difficulty with state variations with good reasons.

MS. SHIRLEY HWEI-CHUNG SHAO: Harold has explained the reasons for state variations. I will now present the challenges from a large company's perspective. I will also discuss some variations I am aware of for the 1996 year-end, and then go over the American Academy of Actuaries' effort in addressing the challenges.

Adopted in the early 1990s, the new NAIC model Actuarial Opinion and Memorandum (AOM) language explicitly requires compliance with domiciliary state's minimum standards and minimum aggregate amounts in each filing state. This latter explicit requirement was new and presented many challenges for the actuaries.

In addition, the introduction of the appointed actuary concept in the new Standard Valuation law model explicitly puts the burden on the appointed actuary. It really makes a difference when someone's signature is involved.

Going back to the 1940s, when the SVL was first introduced, its language was and still is confusing. A strict reading may mean that companies have to comply with each filing state's minimum standards -- that's worse than today's aggregate test in the AOM! In practice, however, most companies complied with their domiciliary state's minimum standards only and foreign states would accept the domiciliary state's valuation.

With the new SVL, the appointed actuary has to comply with each filing state's requirements on an aggregate basis. What makes matters worse is the retroactive aspect of this change.

Products were priced based on the domiciliary state's requirements, but with the new requirements, appointed actuaries may need to strengthen reserves for all in-force business. This can be very troublesome and prohibitive.

What are some of the challenges facing large companies? In the case of Prudential, the company is complex in terms of organizational structures, where numerous reorganizations certainly have not helped understanding the latest structures and businesses.

The other two major challenges -- source of information on variations and compliance costs -- are not limited to large companies but the problem can be more magnified.

Prudential is organized into several fairly autonomous business groups. It sells and administers life, health and annuity products.

Each of the business groups has its own actuarial staff, and none of these actuaries report directly to the appointed actuary. Therefore, all of the formula reserve calculations and asset adequacy testing are performed on a decentralized basis at different geographic locations.

A business group may contain multiple product lines, and the assets supporting those product lines may be contained in several different asset segments in the general account and in different separate accounts.

Altogether, there are probably 75-100 actuarial and investment people involved in the process of valuing over $150 billion of reserves ($153 billion without asset valuation reserve (AVR) plus interest maintenance reserve (IMR), $156 billion with).

Prudential is licensed in all 50 states, Washington, D.C., and Puerto Rico. Therefore, it is subject to more than 50 sets of valuation requirements.

The valuation actuary in a business group first needs to compile and analyze each state's minimum valuation requirements. To the extent one product line cannot meet these requirements, a further understanding of that state's aggregation requirements may become necessary. It is not always easy to figure out at what level aggregation should be performed -- should it be at a specific product level, product line, or for the whole company.

There is not one reliable, definitive source for uncovering variations. In theory, the actuary should thoroughly review relevant laws, regulations, bulletins, letters, actuarial guidelines, and so on, in each state.

In practice, most actuaries rely on various sources where summaries are provided, but none is perfect. They are often inaccurate, subject to errors, not updated on a timely basis, or do not provide enough detail to be used as a stand-alone resource.

The costs of complying with more than 50 sets of requirements can be high. The first source of costs comes from all the research in compiling, analyzing and computing variations. For example, last year, Prudential performed a detailed review of the group life and health valuation requirements in all 50 states. It was very time-consuming and tedious, and it took about four actuaries over one month's time.

At the end of this exercise, it is sometimes necessary to set up additional reserves. These reserves are likely to be redundant and are not very desirable in today's risk-based capital (RBC) world.

Both Prudential and its actuaries are financially liable for any noncompliance to these more than 50 sets of rules. I do not know how to put a price tag on this cost.

I will now identify some state variations for the 1996 year-end.

In 1995, the NAIC adopted Regulation 830 which is better known as XXX. So far, only New York has adopted a substantially similar version. Illinois adopted XXX, but leaves the effective date open until states with 51% of the population adopt a substantially similar version of XXX.

According to the survey by the NAIC last May, about eight more states are considering adopting the regulation in the near future. The NAIC is hoping for uniform adoptions with the same effective date of January 1, 1997, but it looks like it is going to be just a dream. States are worrying about 1) higher costs to the consumers; and 2) an unlevel playing field if other states do not act.

California will accept Guideline XXX, but requires gross premium valuation and an actuarial opinion confirming that the reserves are adequate. This is for all in-force and new business. It is not clear whether this is a separate opinion or whether it can be combined with the asset adequacy testing of other similar products.

Florida has the XXX type of provisions (i.e., segmentation) in its SVL, which has been in existence since 1979. It is enforcing the SVL actively on new business.

In 1983, the NAIC adopted a Variable Life Insurance (VLI) Model Regulation that included a requirement to hold a minimum death benefit guarantee reserve (MDBGR). In 1989, the NAIC amended the regulation and changed the MDBGR requirement. The 1989 version generally requires a lower MDBGR than the 1983 version. However, at the present time, 23 states still have the 1983 regulation on their books. Only seven states have adopted the 1989 regulation. The remaining states have not adopted either regulation.

For variable annuities, most states only require that the reserves reflect the variable nature of the contracts. New York does have a regulation requiring that a MDBGR be held pursuant to a plan to accumulate it to an appropriate amount. Connecticut requires the use of the VLI MDBGR for nonincidental death benefits. The American Academy's Working Group has published a white paper recommending the MDBGR reserve standards and Actuarial Guideline MMM to go with it. The current draft report would require a combination of a benefits CARVM calculation based on an immediate drop in the value of the separate account assets, followed by growth at an assumed long-term rate of return. The amount of the immediate drop and the assumed long-term rate of return would vary depending on the nature of the assets.

MR. THOMAS A. CAMPBELL: At year-end 1995, all but ten states had passed the Actuarial Opinion Memorandum Regulation. Almost all of those ten states will be passing the regulation this year. I think it is fair to say that some of those ten states have been historically slow to pass other model laws and regulations, and this could cause problems for valuation actuaries in terms of meeting minimum reserve standards. Many of these states have old and unusual reserve requirements, and have adopted mortality standards later than other states.

I recently came across a provision that deals with annuity valuation. When one state amended its Standard Valuation Law in 1996 to require actuarial opinions, nothing else in that law was updated. The state has never changed its requirements for annuity reserves to the current model law provision that requires the greatest present value. Their current requirement was passed in the early 1960s and can be interpreted many different ways -- including full fund value.

It is unclear how to resolve issues such as these. One way is to file a separate annual statement in that state. Another is to file a separate opinion. I do not necessarily like either of those options, and prefer to contact states that have different requirements to discuss their interpretation and to come to some agreement. Of course, this is a very time-consuming process. I would like to hear what other companies have done in these situations.

MS. SHAO: While a literal reading of the SVL arguably calls for curtate CARVM, several states, either by regulation or administrative practice, require continuous CARVM. I was just told that California will no longer require continuous CARVM despite its actuarially sound basis. The state's legal staff has just reviewed the SVL recently and concludes that the SVL only requires curtate CARVM.

In 1988, the NAIC adopted a regulation for reserving individual and group health insurance. For group long-term disability, it required the 1987 Commissioners' Group Disability Income Table (CGDT) and allowed modification in the first two years of disablement. Whole life valuation interest rates were also required. This regulation was amended three times since its adoption. In the latest version, single premium immediate annuity (SPIA) rates minus 100 basis points are allowed and three-to-five year experience modification is allowed with prior approval.

The problem is that not all the states have adopted the latest version or the same version or any version at all. This creates a state variations problem.

New York requires Type B rates for structured settlement lump-sum payments. NAIC guidelines permit Type A rates. Even when states adopt NAIC models as originally written, problems arise when the effective dates vary.

Last December, the Academy formed a task force to address state variation issues related to valuation. The Academy is concerned about the professional responsibilities that appointed actuaries are taking on. In law, the word "responsible" is synonymous with the word "liable."

The actuaries are personally certifying that formula reserves meet all filing states' requirements. Under the model AOM, the appointed actuary is limited to a liability to his or her insurance company and to the commissioner. The commissioner is authorized to discipline an actuary who either breaches the SVL or AOM requirements.

Not all the states will necessarily adopt the model. Some may go beyond the model and include either gross negligence and intentional misleading behavior, for which the one is liable to the world. Please understand that if you make a false opinion, even inadvertently, you may be in serious legal trouble.

Legal obligations aside, one also has professional obligations that are overseen by the Actuarial Board for Counseling and Discipline (ABCD). If you are a member of the Society of Actuaries or Academy of Actuaries, the Code of Professional Conduct applies.

At the same time, companies are "right-sizing," forcing professionals to do more work with less time and fewer resources but still expecting them to get to the right result. Some may even feel pressured to sign an opinion.

Some states do not appreciate seeing "qualified" language in the opinion while others probably could not care less, especially for opinions from nondomiciliary states.

We should ask ourselves -- do we want to raise our next generation of actuaries to just comply with 50 sets of state rules? At the rate we are going, this could be a full-time job for most of our professionals by the year 2000! I know at least one consulting firm that has lost some actuaries due to this type of "brain-numbing" work.

The pressure on an appointed actuary is coming from all different directions and the actuarial profession is still grappling with the meaning of all the pressure.

The Academy's task force presented a report in May 1996. We recognize this is not a problem that is going to go away quickly, so we set two objectives. First is a short-term fix to allow states to accept an actuarial opinion based on the valuation requirements of an insurer's domiciliary state. This is a solution that can be relatively easily implemented under the current valuation system in the U.S. The success of this solution depends on uniformity in states' requirements. The Academy is working hard to encourage state uniformity in the adoptions of the NAIC models on the sales illustration regulation and XXX, for example.

Taking a long-term perspective, however, we believe the current valuation system in the U.S. needs to be revisited. We recommend three language changes to the AOM regulation. The first is to recognize the preeminence of the domiciliary state's valuation requirements. An actuary will opine based on the valuation laws, regulations, bulletins, letters, etc. from the state of domicile. Foreign states continue to have the authority to accept or decline this opinion. However, the appointed actuary will be required to comply with foreign states' aggregate requirements only if he or she receives a notice of decline. The burden of compliance with foreign states' requirements is shifted to the state commissioners.

The second recommendation is to eliminate the small company exemption. Currently, depending on the size of admitted assets and surplus-to-asset ratios, some companies perform asset adequacy testing every three years and some are completely exempt. The companies currently performing the test every three years seem to think the impact of doing it more often is minimal and may, in fact, help since it is difficult to reconcile what happened three years ago. However, for companies that currently do not have to do any asset adequacy testing, this is a big blow and Jim will focus on specific issues.

The rationale behind the elimination is that we believe a uniform actuarial opinion is important for policyholders and regulators. In addition, this will give foreign states comfort that the formula reserves established by domiciliary rules are adequate (i.e., they allow the valuation actuary concept to work when it comes to foreign state compliance).

The third recommendation is to disclose any special approvals obtained from the domiciliary state to all licensed states. Our conclusion is that additional work is not necessary since the current AICPA Standard of Practice (SOP) 94-5 requirements effective at the end of 1995 have already asked for this. Specifically, SOP 94-5 requires the insurers to disclose permitted practices that materially affect statutory surplus or RBC individually or in aggregate.

In addition to these three changes to the AOM, our task force is currently working hard on developing a central depository system which summarizes each state's variations from the NAIC models. The primary users for this system will be state regulators to help them better understand other states' variations. Therefore, there is no need for any references in the AOM, which is for the appointed actuaries to comply with.

The valuation system in the U.S. has evolved over the years to where it is now. There are two distinct and sometimes competing concepts: formula reserves and the valuation actuary. On the top of these two concepts, multiply them by 50 and we have constraints that are certainly unique to this country.

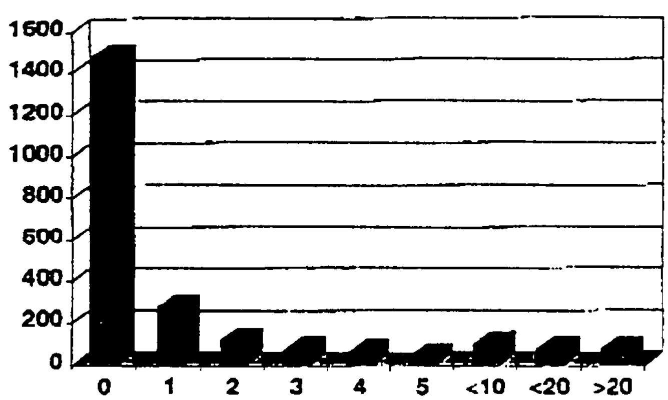
Our task force would perform a complete review of the valuation system and propose appropriate measures. This may mean developing a framework that places more emphasis on the valuation actuary concept (or, at the minimum, achieving more unified formula reserve standards).

We recognize this is a difficult task but feel that it is crucial for the industry as well as for our profession. We will need your support in shaping the future of our actuaries to be bright and interesting.

MR. JAMES N. VAN ELSEN: I will be covering some of the differences between smaller companies and larger companies. I will address the benefits and the difficulties resulting from the Academy's recommendations. Then some proposed alternatives will be presented.

Smaller companies have fewer assets, employees, and policyholders. They are also of much less concern to the regulators. The failure of smaller companies has significantly less impact than that of a larger company. Most smaller companies will be forced to put the burden of asset adequacy analysis on very few people. The typical small company chief actuary has many responsibilities such as managing underwriting, policyholder services, accounting, annuity services and data processing. In today's environment, the illustration actuary would be added as an additional responsibility to the appointed actuary. If some of the regulations being considered by the NAIC are adopted, a small company actuary would be wearing several more hats. I believe that companies with limited actuarial resources are not adequately represented in these discussions as some companies do not have an actuary (see Chart 1). The most recent actuarial yearbook shows that 64% of these companies do not have an actuary on staff.

CHART 1
Number of Actuaries Per Company



Smaller companies have fewer financial resources while the cost of sophisticated actuarial software is very high. They also tend to be in fewer states and do not benefit nearly as much as the larger companies from a domiciliary state opinion. Smaller companies tend to focus on a narrow range of products while larger companies tend to have a larger number of more diverse products.

Now I'll go through some of the benefits that the smaller companies will gain from the task force recommendation. Small companies that are in many states would benefit from recognition of the preeminence of the domiciliary state laws. There would also be less potential liability to those actuaries that are able to rely on those opinions. There would be less work required, and it would simplify many product development issues.

Information contained in a well-prepared asset adequacy analysis would result in better management of asset/liability matching, earlier identification of future problems and better assurance to regulators that promises will be kept.

I recently conducted an informal study of my smaller clients who do asset adequacy analysis. I found that very few of these companies use the reports, other than for regulatory compliance. Although delivered to the board, there is very little discussion of the report. In my own company, in working with a smaller company, I did force my president to sit down with me to review my conclusions. I also received a few questions from one of our more informed board members. Now that I am a consultant, I do sit down with the clients that I am the appointed actuary for. It seems, thus far, for most of them, that there are additional benefits other than compliance.

The central depository system will be of great benefit to all companies and regulators. It will help with compliance by reducing both potential liability for the appointed actuaries and the cost of complying with the various regulations.

Financial cost of performing asset adequacy testing is significant for a small company. Every time I mention cost to Shirley, she points out that Prudential spends over $10 million on their testing. I would maintain that $10,000 is much more significant to some smaller companies than $10 million is to Prudential. For example, a $50,000 cost, which is suggested by some groups, is the average cost for smaller companies. It amounts to about a five-basis-point charge on all assets for a $100 million company. There is also a diversion of very valuable resources. I personally do not believe that the value received by the small insurance companies and regulators exceeds the cost of preparing the reports. Certainly if this were the case for larger companies, we would be re-evaluating asset adequacy analysis for all companies. From my experiences, very few of the small companies that perform asset adequacy testing use the reports other than for regulatory compliance.

There are two sides to the credibility argument. Some say that with less credibility, more testing should be done. The final report, however, does not tell much about the company or why we should be doing it.

The bottom line to my problem with the task force recommendation is that I do not believe that the value received by the companies and regulators exceeds the cost of preparing the reports for many companies. Certainly if this was the case for larger companies we would be reevaluating asset adequacy analysis for all companies.

The following possible solutions are obtained directly from the task force report. One is the use of gross premium valuation, permitted in the Actuarial Standard of Practice (ASOP), to supplement the Section 7 exemption. There is also a discussion that if an actuary finds the reserves to be adequate, asset adequacy analysis would not be required. It will be totally left up to the actuary.

An additional possibility was to add a risk-based capital test to the eligibility criteria, requiring testing of only interest-sensitive lines of business. Also, the effective date may be adjusted to give the companies more time to respond.

Another possibility that has been suggested is to expand the Section 7 exemption to include companies that meet certain tests with regard to risky assets and more interest-sensitive lines of business. We have been talking in our group about providing more education on the alternatives to cash-value testing which are already permitted in ASOP 22. There is now a subgroup, of which I am the chair, working on guidelines for when alternative testing may be used.

A recent compromise that has been offered is that companies who file Section 7 opinions would not benefit from the domestic state recommendation. In other words, their opinions would still reflect language in compliance with the state filed. The ACLI is working on that recommendation.

I am in opposition to the elimination of the Section 7 opinion. I will therefore oppose the task force's implementation of the recommendations if the proposed items are viewed as a single package by the regulators. The ACLI, the Health Insurance Association of America (HIAA), and the NAIC are all opposed to the elimination of Section 7. Unless a compromise is reached that is satisfactory to smaller companies, it is my opinion that these changes will not become universally adopted.

MR. DURAN: Harold Phillips suggested a centralized approach in which the codification project would essentially give us standards to apply nationally. The long-term approach of the Academy Committee that Shirley chairs is to revisit the whole valuation framework. How different is the Academy Committee's long-term approach to the codification project?

MS. SHAO: The task force has limited resources. We have started reviewing the valuation systems in different countries, where either formula reserves or the valuation actuary concept applies. Right now we are still in the review process and do not yet know which path the Academy is going to recommend in the future.

MR. MAULL: Why this elimination of Section 7 and why force small companies into Section 8? Is such an issue relevant to the state variations subject?

MS. SHAO: There are two reasons. One is that we do not think it is professionally sound for certain policyholders to get one type of opinion and others to get another type of opinion. The second reason is that the proposal would eliminate automatic compliance with foreign states' requirements. In other words, companies just comply with domiciliary states requirements unless somebody tells us not to. To give some comfort to the foreign states, we need to convince them of the company's sound financial condition.

MR. VAN ELSEN: A related issue is that when the valuation actuary concept was first negotiated, a compromise was taken to continue the small company exemption. With the proposed change, the original compromise will be undone.

MR. WALTER A. RUGLAND: There were really two issues behind the 1990 law. One was should all companies do an actuarial opinion? The Academy working groups and the NAIC advisory groups said that was appropriate, as Shirley Shao has stated. I believe it is appropriate for us to continue to say that.

On the other hand, a political compromise was made to insert Section 7 into the law. I have trouble believing that tying the two together has any more substance than it did back when the compromise was made. Also, we have spent a lot more time and energy trying to deal with the all-states requirement as opposed to the domiciliary state requirement. I think we are trying to put too much in the same bucket. It is worthwhile to get rid of the all-state requirement, but I am not sure that the quid pro quo is required going forward, given the negotiation that went on at the point of time when Section 7 was inserted.