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NEW YORK'S REGULATION 126 — 13 COMMONLY ASKED QUESTIONS

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New York's Regulation 126 effectively requires all companies doing business in New York to file an actuarial opinion and memorandum on their annuity and GIC business. A number of questions have arisen in connection with this regulation. This article attempts to answer some of the most commonly asked.

1. Why was this regulation written?

For a number of years there was concern within the New York Insurance Department about interest sensitive business. Starting in 1982, New York allowed companies to use the highest rates under the dynamic valuation law for annuity and GIC business, but only if an actuarial opinion and supporting memorandum showing asset/liability management were provided. The Department wanted all companies to file these documents, and some companies did; but there was some concern about the quality.

Legislation in 1985 requires all companies doing business in New York (and all authorized reinsurers) to prove asset/liability management via actuarial documents, *or* to hold stronger reserves. I chaired an industry advisory subgroup proposing regulations on actuarial opinions and memoranda. Another industry group proposed minimum reserve standards. The Department accepted most, but not all, of the industry's recommendations.

2. I have neither the time nor the tolerance to read 92 pages plus appendices. What are the highlights?

Annuity and GIC business must be shown to have adequate reserves by testing that the assets would be sufficient under a variety of interest rate scenarios. The regulation details the items to be considered. There should be consistency among the assumptions; assumed lapse rates on the liability side and pre-payment rates on the asset side should be related to the interest rate scenario under test. Other risks, the default risk on assets and the mortality risk on annuities, are also to be considered.

Minimum reserve formulas are given. The actuary must set up statutory reserves equal to or greater than those he/she considers adequate, given the results of the testing.

3. Must I test all annuity reserves?

There is a grade-in period, but by 1988 all annuity business issued after 1982 with substantial guarantees is subject to the testing. Classes of business invested separately should be tested separately, but the results can be aggregated to determine reserve sufficiency. Future action may bring the pre-1982 business under testing.

4. Who signs the actuarial opinion? What is a "Qualified" actuary?

The concept of Valuation Actuary is still evolving, so the person to sign Opinions in New York is called by a different name — Qualified Actuary. He or she must be a MAAA, must meet the Academy definition of a Valuation Actuary, must be appointed by the insurer's Board to be the Qualified Actuary, and the New York Department must be notified as to the appointment.

5. HELP!! I don't have the capability of testing. What should I do?

There are three alternatives. One is to do no testing, but to hold the additional reserves. A second is to develop testing capability in house, or to buy an asset/liability software package. A third is to find a Qualified Actuary among the consulting firms.

6. How should asset default risk be handled?

The Qualified Actuary is to do what he/she feels appropriate. The particular concern is with junk bonds. The regulation suggests an interest rate hold-back, or substitution of the Moody rate on corporate bonds for junk bond yields, in the cash flow testing.

7. I am not investment trained. How do I project investment cash flow?

Ask your friendly investment officer, or do it yourself via actuarial literature. WARNING: even if you farm out the investment flow projections, the Qualified Actuary is still responsible.

8. The Qualified Actuary seems to have a lot of responsibility. What happens if something is wrong with the actuarial documents?

Boiling-in-oil is not indicated, but the consequences can still be severe. New York, after consultation with the Qualified Actuary, can reject the actuarial opinion and require higher reserves. If the problem is with the QA, the State may bring charges via the AAA.

9. Why the references to Macauly "duration"?

The Macauly duration concept proved to be better in theory than in practice. Problems developed in trying to define duration for most liabilities and some assets. Future legislation may well eliminate these references.

10. The regulation suggests that particular interest rate scenarios be tested. Why?

The scenarios suggested are neither required nor sufficient. If the actuary feels that scenarios other than the ones suggested make sense, he/she should test on his/her own scenarios, and explain why these were chosen.

11. What happens if we fail under one or more scenarios?

Unlike the actuarial exams, it is not required to pass all. If one or more scenarios show reserve deficiency, it is up to the QA's judgement as to whether reserves are nonetheless sufficient. As a practical matter, if the reserves are inadequate under most scenarios, or are insufficient under a level rate scenario, reserves should be strengthened.

12. The Regulation says little about my particular concern. Where do I go for help?

It is well recognized that these 92 pages do *not* answer all questions. Sources of help include (1) other actuaries, (2) the Valuation Actuary Symposium, (3) other actuarial meetings or literature, and (4) the New York Insurance Department.

13. How is this Regulation meant to help?

This Regulation, requiring asset/liability testing but little else, cannot address all of the problems to which a company may be subject. It does force companies to become aware of asset/liability characteristics, important to the understanding of risks undertaken in interest-sensitive products.

I commend the New York Insurance Department, and particularly its Chief Actuary, Robert Callahan, in their courageous step advancing the concept of valuation actuary. □