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Highlights of the December 1999 NAIC Life and Health Actuarial Task Force Meeting

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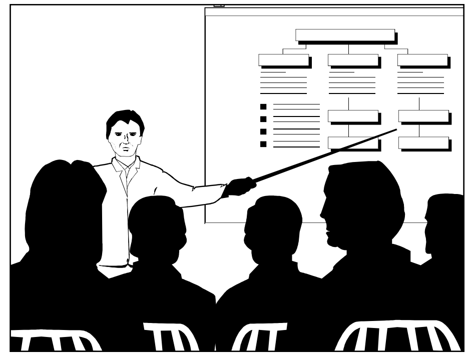

Editor's Note: The NAIC Life and Health Actuarial Task Force met on December 3-4, 1999, and discussed the following projects related to life insurance and annuities.

Innovative Products Working Group

The Innovative Products Working Group discussed the following projects:

Variable Annuities with Guaranteed Living Benefits (VAGLB)

The American Academy of Actuaries representatives presented an interim report of the VAGLB Working Group.

Discussion focused on reserve methods being used by companies in practice, risk management strategies in use, a review of the effectiveness of the Keel Methodology applied to GMIB designs and use of a limited flexibility approach to reserving which could be a substitute or replacement of the Keel method and one that would be considered a CARVM compliant approach.

Reserve methodologies currently being used in practice fall into three main categories:

(i) Modified Actuarial Guideline 34 Methodology: This approach includes AG 34 drops with significantly lower assumed returns than those contained in AG 34 itself which follows some of the initial conclusions of the VAGLB Working Group.

(ii) Retrospective Net Premium Method: The expected cost at issue is used to determine a net premium for the VAGLB, which is reflected in a traditional reserve accumulation formula.

(iii) Market Value Approach: The reserve is determined as the then market value of the embedded option-less the present value of future net premiums.

Reinsurance has played a significant role in some valuation methods, particularly those that cede off most or all of the VAGLB risk.

With respect to the Keel method, additional testing and analysis indicates that a single scenario Keel methodology works well for roll-up GMIB and roll-up GMAB designs currently in the market, but it is not an appropriate methodology for rat-chet GMIB or ratchet GMAB designs.

The VAGLB work group reviewed whether AG 35 "Option Cost" methods should be pursued for VAGLBs and concluded that neither book value nor market value methods described in AG 35 appear to work very well for VAGLBs.

Finally, the VAGLB working group recommended that a "Limited Flexibility" approach be pursued as one approach to developing CARVM compliant reserves for VAGLBs. This approach would provide the valuation actuary some limited flexibility in the determination of representative scenarios developed by the valuation actuary for VAGLB reserves. Return scenario assumptions would be standardized. The actuary would provide a certification that the representative scenarios meet the standardized benchmarking requirements.

The work group has a small number of remaining issues including looking at GLBs and MGDBs in combination, continuing to review other reserve methods for VAGLBs and to bring reinsurance into the analysis.

Because very little reserve accumulates in early years under the VAGLB reserve methodologies, provision for Risk Based Capital has been the most critical current issue. As a stopgap measure, the 1999 LRBC instructions were modified per an AAA recommendation to include provision for VAGLBs. A 1% C-3 factor will apply to the entire reserve (variable account value related reserve plus VAGLB reserve) provided an unqualified reserve adequacy opinion is submitted and the fund balance is not less than the effective floor. Otherwise, a 2% factor would apply.

Reserving for Equity Indexed Life Insurance (AG ZZZZ)

AG ZZZZ had been referred back to LHATF by the Life (A) Committee because a new method that stabilized reserves had been added to AG ZZZZ

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GAAP Textbook

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GAAP accounting for his or her company.

The authors have set a goal for completing all writing and reviewing by June. This will permit the first set of published books to arrive in time for distribution at the SOA's annual meeting in Chicago. There will be a special session where the authors present the text and discuss its content. Those who attend will have the opportunity to receive a copy of the book autographed by all those authors in attendance.

Order forms will be available soon. You should start thinking about how many you want to order. In addition to gracing your own book shelf, don't overlook these as possible birthday or holiday gifts to friends.

The Section wishes to thank its members who are supporting this project.

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prior to adoption of the original version by the NAIC. The revised AG ZZZZ was exposed by LHATF for comment. The reserving inherent in this guideline contemplates a one-year equity indexed guarantee, which is the product standard due to the flexible premium nature of the product. If guarantees extend beyond a year, then an enhancement to AG ZZZZ will be necessary. LHATF plans to schedule a conference call in January or February to review examples provided by the Academy of the reserving required by AG ZZZZ.

Non-forfeiture for Equity Indexed Annuities (NF-ZZZ)
The Academy presented a report on nonforfeiture issues related to equity-indexed annuities. This issue pertains to how minimum guaranteed cash values for new and renewing policyholders should be related. At its root is how the standard non-forfeiture law for annuities should be interpreted with respect to the cash value floor. The Academy noted that companies today are writing into the policy form that the customer renewing for a new term will receive treatment as a new policy owner for the duration of that term if this creates a more favorable result from a non-forfeiture standpoint. LHATF is considering allowing each state to determine its own position with respect to this issue and simply issuing a discussion draft of the issues involved.

Reserving for Bail-Outs Triggered by Insurer Downgrades
LHATF discussed the various reports and letters received from interested parties. The regulators decided to develop an actuarial guideline focused on rating agency bailouts. At the same time, they have asked the Academy to research the liquidity and risk management issue related to these types of provisions. The actuarial guideline would focus specifically on rating agency downgrade provisions and not deal with other features such as put options and other possible embedded options.

Non-forfeiture for Products with Secondary Guarantees (AG XYZ)
LHATF has been considering whether or not to require a XXX type approach to be applied for non-forfeiture inherent in UL policies with secondary guarantees that extend beyond 20 years. Proponents argue that, if a policy behaves like a longer term or whole life type policy, it should be subject to the SNFL just like any traditional life product. Others argue that the market should allow a no-cash value type product because it will be cheaper to the consumer and therefore is in the public's best interest to allow such a product provided they understand the benefits provided under the policy.

LHATF decided to receive comments from interested parties, as well as to provide their own comments to Frank Dino for consideration at the March 2000 LHATF meeting. Then they will decide whether to develop an actuarial guideline focused on UL products with secondary guarantees.

Reserving and Non-forfeiture Beyond Age 100
LHATF will consider several issues related to the general company practice of extending insurance coverages beyond age 100 in order to not trigger tax consequences for centenarian policyholders. Issues include reserves and non-forfeiture benefits before and beyond age 100 and the appropriateness of COI charges beyond age 100. LHATF requested that the AAA prepare a study of the issues both before and after age 100.

Equity Indexed Annuity Survey Results
Regulators reviewed the results of a survey performed by Mark Peavy at the NAIC related to company practices with respect to EIA reserving methods. The largest variances in assumptions used by companies relate to the volatility assumption.

Because of the extensive number of charges that LHATF has on its agenda for year 2000, the task force has decided to disband the Innovative Products Working Group and instead work on and complete one or two projects each quarter using the time previously allotted to the Innovative Products Working Group. At the March, 2000 meeting, the Innovative Product time slot will be filled by a special meeting on international insurance issues to be attended by the NAIC (LHATF, International Accounting Standards Working Group and Codification Working Group), FASB and IASC representatives.

General Matters

At the general matters meeting, LHATF considered the following major projects.

Report on Unified Valuation System (UVS)
UVS was discussed generally and most of the focus was on planning for year 2000.

The regulators plan to have a summary of issues/questions related to the numerical examples that were prepared by the Academy by March 2000. The Academy plans to provide a seminar on UVS to regulators and the actuarial profession, tentatively by September 2000. The Academy will focus on the viability analysis and the role of the valuation actuary, reviewing actuary and the regulator in this context. Key issues are balancing confidentiality and effectiveness. Other items to be addressed include consideration of high impact/low frequency occurrences in the UVS framework. Regulators will begin to consider and put together a list of the items they believe should be included in a viability analysis.

AOMR Revisions

LHATF discussed the most recent revisions to the AOMR. Modifications are based on the results of a recent conference call on November 12, 1999. The latest draft AOMR has references to a Section 7 opinion completely deleted. Much of the detailed requirements contained in the current AOMR will be removed, placing more reliance on actuarial judgment in the context of revised actuarial standards of practice. For example, in this framework, specific required language, comments on aggregation, use of AVR/IMR, and required interest scenarios would be deleted from the regulation itself.

The revisions to the AOMR also attempt to address the problem of state of domicile versus state of filing opinions by giving the Commissioner of each state several ways of accepting a state of domicile opinion. It would be up to each state to decide in what context the Commissioner would feel comfortable accepting an opinion where reserves are established according to the minimum standards of a company's state of domicile. The requirements could take various forms in terms of what disclosure regarding reserve methods and disclosure of reserve amounts a Commissioner might require before a state of domicile opinion would be acceptable. The extremes include certain states that may continue to require a state of filing opinion while others may simply accept a state of domicile opinion if they are satisfied with the state of domicile's laws and regulations regarding minimum reserve standards.

It will be up to the regulators to decide whether the revisions by the ASB to ASOPs No. 7 *Performing Cash Flow Testing for Insurers* and No. 22 *Asset Adequacy Analysis* provide the desired guidance to the valuation actuary. ASOP No. 14 *When to do Cash Flow Testing* would be deleted, and its relevant elements are incorporated in the revisions to No. 7 and No. 22.

Two draft revisions of these ASOPs have been exposed by the ASB to LHATF for feedback prior to a wider distribution to Academy members for official exposure (probably in March 2000). Much of the data eliminated from the AOMR will find its way into the ASOPs in one form or another. Given the nature of the AOMR revisions, it is contemplated that Compliance Guideline No. 4 on Section 7 opinions would be eliminated under this new structure.

New Non-forfeiture Law

LHATF discussed a draft non-forfeiture law which incorporates many comments received by Frank Dino over the last several months. The direction is to construct a new law that would be available to be used on a parallel basis with the current SNFL. The new law would provide for innovative product design (flexibility) in return for significant disclosure, responsibility placed on the company for having a plan for determining charges and credits, and certifications by a responsible officer, certifying actuary and a reviewing actuary for compliance with the provisions of the new NF law.

The new law could be available for use on an optional basis on a form-by-form basis for a ten-year “experimental“ period. The new draft was exposed by LHATF for consideration and comment.

Reserving for Variable Life & Universal Variable Life Products with Secondary Guarantees

This issue is left over from the original adoption of XXX which specifically excluded variable life products. An actuarial guideline has been drafted with two possible reserve valuation methods. The guideline specifies that basic reserves follow a UL model type calculation with an additional reserve layer equal to the greater of an attained age level reserve (AALR) and a reserve based on a one-third drop GMDB methodology. The guideline specifically interprets the SVL in order to avoid any issues with respect to the limited state adoption of the UL model regulation.

New CSO Mortality Table

LHATF received a report from the SOA regarding progress on the development of a new CSO Mortality Table for valuation. The SOA plans to provide three deliverables: 1) a basic experience table to underlie the next CSO table; 2) a research document on possible methodologies to incorporate individual company experience into valuation; and 3) consideration of a formulaic version of a mortality table to be used for valuation.

The 1990-95 SOA experience will serve as the basis for the experience table. The SOA is in the process of trying to accumulate data from other sources for issue ages above 75 and attained ages above 95 where insurance data is scarce. They expect an initial experience table to be available in March 2000.

ACLI Update on XXX

The ACLI provided a brief update on XXX adoption by the states. At least nine states have adopted XXX to be effective January, 2000. In total, about 39 expect to adopt XXX, many of the states plan to adopt in year 2000, but with a January 1, 2000, effective date. Nine other states have XXX under consideration. Only three states are not presently considering XXX.

Shadow Accounts in UL Products

At the fall 1999 LHATF meeting in Atlanta, regulators discussed shadow fund accounts in UL products. Generally, all regulators concurred that shadow accounts should be reserved using a XXX hump back reserve approach at a minimum by computing an imputed level premium based on the guarantee implicit in the contract. It appears that most states will review policy form, advertising, marketing and illustration material and then decide whether new designs should fall under XXX type reserve requirements. Some states are actually modifying the NAIC XXX model to provide more flexibility in its application in this regard.

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The next LHATF meeting will be held in Chicago on March 10 and 11, 2000.

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