



SOCIETY OF ACTUARIES

Article from:

The Financial Reporter

December 2002 – Issue 51

Highlights of the September 2002 NAIC Life and Health Actuarial Task Force Meeting and Other NAIC Topics

by Ted Schlude

I attended the Fall NAIC meeting held September 9-12, 2002 in New Orleans. Summarized below is what took place at the Life and Health Actuarial Task Force meeting and selected other NAIC working group meetings.

LIFE AND HEALTH ACTUARIAL TASK FORCE (LHATF)

Summarized below are the topics considered by LHATF.

1. New CSO Mortality Table and Model Regulation: LHATF adopted the New CSO Model Regulation and forwarded it to the Life A Committee, which I understand also adopted the model regulation. The mandatory effective date of the model regulation was pushed back one year to January 1, 2009. Companies electing to use the new table will be required to submit an actuarial opinion which reflects a Section 8 asset adequacy analysis. The mortality tables themselves will appear in the Second Quarter 2002 Proceedings of the NAIC. The Proceedings will include ALB and ANB tables as well as gender blended tables at 100 percent, 80 percent, 60 percent, 50 percent, 40 percent, 20 percent and 0 percent male/female content. The final model eliminated language that would have required submission of mortality experience data to the state, because it was unworkable.

2. Variable Annuities with Guaranteed Living Benefits (VAGLB) — Interim Actuarial Guideline MMMM: The working group discussed a draft developed by the Academy which takes an accumulation of charges approach to the VAGLB reserve, with an asset adequacy analysis required for the VAGLB reserve at the VAGLB benefit level as an overall test of adequacy. The current draft would be an interim guideline, pending completion of the C-3 Phase II project. Discussion focused on several aspects of MMMM including:

- Point at which the minimum cash value floor comes into play. The VAGLB reserve will be held on top of a basic CARVM reserve calculation that has been subjected to a cash value floor.

- Requirement for an imputed charge and making clear that the valuation actuary is not put into a position of second guessing the pricing actuary.

- Asset Adequacy Analysis Requirement: The working group cleared up any ambiguities in the language used to describe the Asset Adequacy Analysis, which historically has been an aggregate test.

It is hoped that the timeline will result in Life A Committee adoption one-month prior to, and adoption by the Executive/Plenary Committee at, the Winter 2002 NAIC meeting.

The Academy indicated that it anticipated that the C-3 Phase II project will be completed by December, 2003. It is anticipated that the VAGLB interim guideline would be effective for December 31, 2002, December 31, 2003, and possibly December 31, 2004, until a complete Reserve/RBC framework is adopted based on the results of the C-3 Phase II project.

3. Non-Forfeiture for Universal Life and Variable Life Products with Secondary Guarantees: Frank Dino's current draft dated August 9, 2002 was discussed. It was noted that there were no new comments pertaining to the draft that have not already been considered in the August 9, 2002 version.

An individual from The Hartford presented an alternative to the draft model regulation which uses a UL Model Regulation approach to define the minimum non-forfeiture benefit under a UL or VUL policy with secondary guarantees. In the minimum non-forfeiture calculation, valuation mortality would be scaled down to reflect the underlying pricing levels on an approximate basis.

Because the Hartford presentation and materials did not receive wide distribution prior to the meeting, these proposals will be considered and discussed in a conference call prior to the December, 2002 NAIC meeting.

4. General Non-forfeiture Project: LHATF reviewed minutes from an August 29, 2002 conference call. The Academy had already provided a report to regulators on industry practices with respect to non-guaranteed elements. Focus still revolves around using disclosure as the effective mechanism for nonforfeiture. Regulators asked the ACLI and AAA to prepare summary recommendations in bullet form for the structure of a new non-forfeiture law. Finally, Doug Bennett will survey regulators to develop information with respect to what regulators feel the goals and principles of non-forfeiture should be.

5. Annuity Non-forfeiture: Several documents pertaining to annuity non-forfeiture were considered by LHATF including a draft Academy report related to alternative bases for minimum non-forfeiture interest rates tied to an index (leaning toward a swap curve less 150 bps).

Next, the ACLI presented its annuity non-forfeiture proposal, which ties the non-forfeiture minimum interest rate to the five year Treasury less 2.5 percent (with a 1 percent minimum and 4 percent maximum rate). Regulators were generally uncomfortable with the level of implicit load allowed by the ACLI draft. One state included written comments stating that loads for any products (Single or Flexible Premium) should not exceed 10 percent of premium. There was also significant discussion related to the possibility of negative interest credits. The ACLI argued that disclosure and competition will serve to limit the load and the extent that prior credits could be forfeited.

Finally, the ACLI indicated that fifteen states have adopted the 1.5 percent minimum interest guarantee on a temporary basis. About two-thirds of these states have sunset provisions (typically July 1, 2004) which would kick the rate back up to 3 percent after a certain number of years.

LHATF plans to have several conference calls focused on an index rate prior to the December 2002 NAIC meeting.

6. 2003 GRET Factors: LHATF adopted the factors and moved the 2003 GRET proposal to the A Committee for adoption. A summary of the 2003 factors proposed by the Academy was exposed in March, 2002. Generally there were relatively small changes in the factors since the 2001 factors.

7. Moody's Indices: A Merrill Lynch paper discussing alternative sources of interest rates for discounting insurance liabilities was reviewed in a conference call prior to the meeting. Moody's index is no longer readily available to the NAIC for use in valuation rate determination. LHATF decided to defer work on this project until other higher priority projects have been completed.

8. Revisions to the Standard Valuation Law: LHATF discussed minutes from a conference call, a draft valuation law (Dino, Hartnedy) that attempts to simplify the valuation process for the opining actuary, and an Academy report on a long term solution to statutory valuation. The conference call notes outline the major areas of change that are being contemplated in the draft valuation law:

- Allowing a state of domicile opinion provided 1) asset adequacy analysis is performed, 2) the state of domicile is accredited and 3) the company's RBC ratio is 150 percent or higher (based on Company Action Level RBC).
- Eliminates deficiency reserve requirements.

The Academy then gave a brief report on its reorganization with respect to valuation, RBC and the examination function. The Academy is moving in a direction that would promote more accountability on the part of the actuary, the regulator and company management.

9. SSAP Working Group Referrals: A draft response to the SAP Working Group related to Issue Paper No. 117, Accounting for Demutualizations, MIHC's, etc., was discussed. Regulators would support a policyholder dividend obligation (PDO) being established if closed block assets exceed closed block liabilities. The response was exposed for comment.

continued on page 14

10. Modco Treatment in RBC: The LHATF and Life RBC Working Group will jointly study modco treatment in RBC. This issue was originally brought up as part of a study performed by Illinois to identify C-1 risk passing from direct writers to reinsurers under modco agreements.

11. Mortality Assumptions Reflected in Sales Illustrations: LHATF received a letter from Northwestern Mutual related to a project LHATF may consider regarding old age mortality assumed in sales illustrations, and the use of the 1975-80 table compared to the 1990-1995 table. Arguments presented were that use of the older table appears to build in a rather aggressive mortality improvement assumption, compared to the slope inherent in more recent tables at issue ages of 55 and over.

12. 2003 Charges: Charges (objectives) for 2003 were adopted. One charge related to statutory valuation guidance for substandard, guaranteed issue and simplified issue mortality may be added.

13. Revised AOMR Adopted by Statutory Accounting Principles Working Group: Finally, LHATF will begin to consider the effect that adoption by the Statutory Accounting Principles Working Group of the revised AOMR at the September, 2002 meeting could have on year-end 2002 financial statements. In particular, the implications of SSAP No. 1 – Disclosure Requirements will be reviewed, given that no state has officially adopted the revised AOMR, but it will be effective in codification for year-end 2002, which normally would be considered as requiring disclosure in the financial statements.

NAIC ACTIVITIES

Notes with respect to other meetings I attended are provided below.

1. Viatical Settlements: The working group discussed the model regulation and buyer's guides. Part of the discussion focused on recent state policy form filings where the policy form itself forbids the policy owner from viaticating the policy.

Regulators are considering whether these provisions are acceptable from a public policy standpoint.

Discussion about the viatical settlements model regulation revolved around the responsibilities of the company and the broker in terms of the minimum standards and suitability.

2. Reinsurance Task Force: The Reinsurance Task Force continues to discuss collateral requirements, use of an approved reinsurers list, working trusts and credit for retrocessions. Small workgroups were established to study practices in Bermuda, France, Germany, Switzerland and the U.K.

Documents distributed at the meeting include: 1) a comparison of U.S. Regulatory requirements to those of the U.K., E.U., and Bermuda; 2) a report from Stroock & Stroock & Lavan LLP on the importance of non-U.S. reinsurer collateral requirements. Representatives from Germany, the U.K., France and Switzerland will be in attendance at the Winter NAIC meeting to present their viewpoints.

The Reinsurance Association of America also presented an updated report on penetration by alien insurers into the U.S. reinsurance market.

Finally, it was noted that the International Association of Insurance Supervisors will be meeting in Denmark to discuss a standard for reinsurance supervision.

3. Life RBC Working Group: The Life RBC Working Group adopted minutes from prior meetings and conference calls and then proceeded to discuss the following topics:

- Academy Modco Report: The American Academy of Actuaries presented a modco report dealing with the dividend liability. When the modco revisions to incorporate recognition of C-1 and C-3 risk transfer were made two years ago, no consideration had been given to the dividend liability. One half of the dividend liability is included in the total adjusted capital (TAC) calculation. This proposal would adjust the dividend liability to recognize modco

Discussion about the viatical settlements model regulation revolved around the responsibilities of the company and the broker in terms of the minimum standards and suitability.

reinsurance in the TAC calculation. The report was exposed for comment, and, if it moves forward, might be effective for 2004 RBC calculations.

- **Affiliated Investments:** Study will continue related to different treatment accorded affiliated investments under the Life, P&C and Health formulas.

- **Deferred Tax Asset Survey:** The Academy discussed an informal study of DTA's filed in the 2001 year-end statutory financial statements. Generally 30-40 percent of the total DTA's were admitted at 2001 year-end. Three major contributors to DTA balances are statutory/tax reserve differences, DAC proxy taxes and non-admitted assets (write-offs appear to create a significant DTA until the asset is actually sold and the DTA is realized).

- **Worker's Comp Carve Out and Guaranteed Separate Accounts Projects:** The working group received an oral report, and there is hope for a formal recommendation at the December, 2002 NAIC meeting.

- **Fraternal:** Regulators discussed a project which would apply Life RBC to fraternal companies (currently fraternal are not subject to any RBC filing requirements). There will be a conference call to discuss the project and a letter to states explaining the work being done in this area.

- **Modco (continued):** A more comprehensive project related to Modco reinsurance and RBC was discussed. The discussion included:

- **Unauthorized Reinsurers:** Use of letters of credit or funds withheld to support reinsurance credits for RBC.
- Review rules related to marking assets to market for trust or escrow agreements. Check for consistency with book value accounting generally.
- Consider reflecting the transfer of credit risk in the determination of bond size and asset concentration factors.

- Consider recommending that NAIC staff begin including information on RBC modco and coinsurance funds withheld worksheets in the RBC database.

4. COLI Working Group: The focus of this group relates to providing protection to employees covered under COLI plans (insurable interest, consent and opt-out provisions, transparent understanding of the coverage and benefits, etc. are all under consideration).

5. Life Insurance (A) Committee: It should be noted that the Life (A) Committee took the following actions:

- **Adopted New CSO Model Regulation:** Will be forwarded to Executive/Plenary for adoption in December 2002.

- **Adopted Liquidity Risk Working Group Report:** This report requires disclosure information in the footnotes to the financial statements relative to an insurer's exposure to stress liquidity risk.

Finally, Actuarial Guideline AXXX was adopted by the NAIC in September 2002. This guideline has retroactive applicability, except for shadow account products, where it would apply to new issues on or after January 1, 2003.



The next NAIC meeting will be held December 5-10, 2002 in San Diego, California. ☒



Ted Schlude, FSA, MAAA, is a consulting actuary at Milliman USA in Chicago. He can be reached at ted.schlude@milliman.com.