small talk

NEWSLETTER OF THE SMALLER INSURANCE COMPANY SECTION

ISSUE 15 APRIL 2000

Are Small Companies Victims of Overregulation?

by Jim Connolly

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In an S.900 world, are regulators doing enough to make sure that small, independent insurers don't disappear into oblivion?

The question was raised in a letter sent to insurance commissioners by James Van Elsen of Van Elsen Consulting in Colfax, Iowa, who frequently represents the interests of small companies.

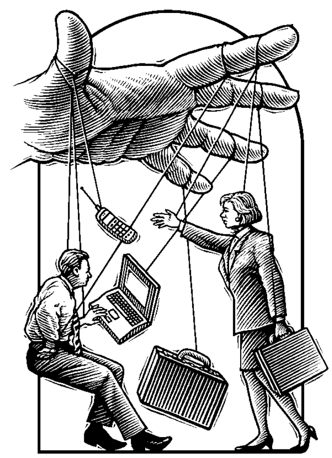
In the letter, Mr. Van Elsen starts by noting that "every year, there are fewer independent companies as smaller companies are acquired by or merged with larger companies."

In the course of the letter, Mr. Van Elsen writes that an insurance commissioner has a "significant influence on whether smaller companies will continue to disappear."

Insurance commissioners, according to Mr. Van Elsen, must examine the cost of mergers and acquisitions as well as insist on a better analysis from the National Association of Insurance Commissioners when new regulations are being proposed.

"Many new regulations offer very little protection to the public, but continue the assault on the smaller companies' ability to stay in business," he wrote, citing the new model Actuarial Opinion & Memorandum Regulation being considered by the Life & Health Actuarial (Technical) Task Force of the NAIC as a case in point. This regulation's possible cost of requiring a gross premium valuation, he wrote, was a reason for concern by small companies.

The AOMR draft would require all appointed actuaries to render an opinion concerning the adequacy of a company's



reserves, something smaller companies say would be an onerous added expense.

Mr. Van Elsen that state laws regarding mergers and acquisitions need to be changed because commissioners are limited in what actions they can take.

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Small Talk from the High Chair

by Rod Keefer

Those of us who have school-aged children know that May's arrival means two things are not far behind: (1) summer vacation and (2) report cards. While most eagerly anticipate the former, many await the latter with mixed emotions, as the objective assessment of how one's performance compares with expectations can result in much anxiety.

As the Smaller Insurance Company Section approaches its seventh anniversary, perhaps it is a good time for a report card that measures our performance in light of our purpose. Combined, the five bold headings below comprise the Section's purpose as it appears on page 141 of the 1999 SOA *Yearbook*. Along with the purpose are some of the items that are being done to fulfill that purpose, as well as a few suggestions for

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From the Editor

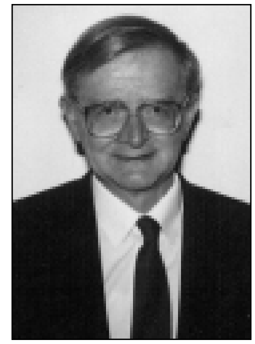
by James R. Thompson

We try to have one or two themes for each issue and to provide a little variety. Yet as I survey the scene, I hear the constant inevitable hoofbeat of more regulation. Thus a quote from a poem, "The Highwayman," by Alfred Noyes is in order:

And still of a winter's night, they say,
when the wind is in the trees,
When the moon is a ghostly galleon
tossed upon cloudy seas,
When the road is a ribbon of moon-
light over the purple moor,
A highwayman comes riding —riding —
riding —
A highwayman comes riding, up to the
old inn-door.

This should convey the mood as we feel the hot breath of the pursuing horse and horseman on our backs. If we have to pick two common themes, however, they are the most recent meeting of the Life and Health Actuarial Task Force (LHATF) of the National Association of Insurance Commissioners and the roll-out of XXX and the associated term products.

XXX has not been passed by all states. For a regulation that was supposed to be fully in force by January 1 2000, it is way behind. Many states have merely stated they intend to pass it. What will it do to pricing? How will the associated American Academy of Actuaries Actuarial Standard of Practice affect it?



James Thompson

How will companies comply with the intricate X factor requirements and maintain competitive preferred class premiums? We have an article by Doug Robbins on this. Although the products in this market are often perceived as "big-company," the changes in the competitiveness should affect sales among those companies that do not offer them.

The lead article is a reprint from the National Underwriter on overregulation of the smaller companies. This quotes heavily form Jim Van Elsen's letter to insurance commissioners. Rod Keefer's article on the Membership Survey explores the members' concerns on a broad array of regulatory issues, including XXX and changes in the AOMR. This is one example of the depth of concern about the course of regulation. At the recent LHATF meeting, there was a discussion of expressions of concern from other organizations, including the ACLI, the NALC (National Alliance of Life Companies) and the National Fraternal Congress of America, when it came to a proposal to change the current AOMR to eliminate the Section 7 exemptions. Two articles by Don Maves and Jim Thompson discuss various developments.

In his "Small Talk from the High Chair," Rod Keefer calls for members to become involved. The gap in perceptions between the regulators and the regulated on the importance of some of the regulatory proposals should cause each member to think for himself what he (or she) can do. The company you save might be your own.

***James Thompson, FSA, is a consultant with Central Actuarial Associates in Crystal Lake, Illinois, editor of* small talk*, and a member of the Smaller Insurance Company Section Council. He can be reached at* jrthompson@ameritech.net.**

SMALL TALK

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"Generally states don't have a lot of latitude objecting to sales [of companies]."

Where insurance commissioners do have more authority, he noted, is to make sure that there is not just "regulation for regulation's sake." There needs to be a "more critical" look at why regulation is needed as well as the benefits and costs, he added.

"I do think that the issues he raises are ones that we take pretty seriously," said Kathleen Sebelius, NAIC vice president and Kansas commissioner.

Insurance commissioners are concerned with policyholder protection and the value of policies, but there are some intangibles that move beyond regulators' jurisdiction, she said. It is within regulators' jurisdiction to make sure that there are sufficient assets to cover a policy, Ms. Sebelius said.

NAIC's process of developing model laws and regulations is open enough to ensure that the issue of costs is adequately addressed, she said. In fact, according to Ms. Sebelius, regulatory reengineering efforts, both in Kansas and nationally, have been ongoing in an effort to eliminate both cost and time.

For instance, Ms. Sebelius said, in the last five years in Kansas 30% of insurance regulations and 25% of insurance laws on the books have been eliminated because they were antiquated.

"Financial trends are moving toward consolidation," she said. Fifteen years ago, Kansas had three times the number of domestic companies that it currently has today, she said. There were many property-casualty companies that were either too costly to operate or did not have a broad enough policy base to withstand bad weather for several years, she explained.

"I don't disagree with the sentiment," she said, but "you could close your eyes and change the terms and it could be an article about banks or other financial institutions.

"We can only ensure that there is ongoing policyholder protection. We don't have control over whether the home office is in Topeka or Tokyo," she said.

In Iowa, according to Terri Vaughan, insurance commissioner and NAIC secretary-treasurer, statutes identify criteria for mergers and acquisitions, including guidelines for ensuring that the financial condition of the acquired insurer is not affected.

> ***"Many new regulations offer very little protection to the public, but continue the assault on the smaller companies' ability to stay in business."***

"Losing a niche is certainly not a reason that we could deny a change of control," she said.

Ms. Vaughan said she believes regulators do take into account the cost of regulation and added that the minutes of recent Life & Health Actuarial (Technical) Task Force conference calls indicate that the issue of cost has been discussed.

She said that with the AOMR project, it was her understanding that efforts were being made to include a number of options in the model.

Ms. Vaughan said that if industry representatives believe the cost of regulation is an issue, then they need to make regulators aware of the facts. However, she added, that does not necessarily mean regulation should not be enacted because there is a cost associated to regulation.

Scott Cipinko, executive director of the National Alliance of Life Companies in Rosemont, Ill., said solvency standards are "good and important," but "there needs to be a holistic approach to regulation."

He expressed concern that small companies not bear a "disproportionate cost of regulation that is really overregulation," although he said he believes regulators are trying to maintain a balance.

Linda Lanam, vice president and chief counsel of legislative relations with the American Council of Life Insurers, Washington, said the Forum 500, the ACLI's small company group, is watching how the AOMR project develops.

But she said the issue of consolidation and the possibility of becoming an acquisition target are things that companies of all sizes face.

Although care needs to be taken over what expenses are created for small companies, Ms. Lanam said regulators have the challenge of regulating effectively while being aware of the effect their regulation can have on companies and the potential for creating disparities among different size companies.

Determining whether there is regulation for regulation's sake is difficult, Ms. Lanam said. When regulators see a problem they want to solve, regulation is the tool they have to work toward a solution, she said.

Additionally, there are different perspectives over what model regulations should accomplish, Ms. Lanam said. Is model regulation simply a guideline to a solution or is it a solution created when there is a national insurance issue, she asked.

Jim Connolly is a writer for National Underwriter.

Results of the Smaller Insurance Company Section Membership Survey

by Rod Keefer

In the May 1998 issue of *small talk*, John Wade challenged the Smaller Insurance Company Section Council to "develop an issues survey that will help us better profile our constituency and identify the issues that are important to them." While not as extensive as what John may have in mind, the Council took a step in that direction in August 1999 by distributing a survey to Section members on valuation issues and strategies.

The survey was designed to identify the most critical items facing valuation actuaries in smaller insurance companies. Responses were compiled and distributed to the panelists for Valuation Actuary Symposium (VAS) Session #18, "Small Company Valuation Issues." A transcript of that session will be available on the SOA Web site soon through the new Alta Vista search engines (under Resources), and copies of handouts on CD-ROM are available now.

The survey was distributed by e-mail to about 500 of the Section's 700+ members and by regular mail to the others. This "blast" e-mail distribution was the first of its kind attempted by the SOA. As more members come on-line and provide e-mail addresses for publication, we can expect more communications of this sort in the future.

A total of 53 responses were received. Question #1, which asked respondents to classify their current employers, revealed that about two-thirds (35) were working at insurance companies. Another 13 were consultants, while the remaining 5 worked for reinsurers or other firms. This distribution was consistent with our Section's membership as a whole (see "Small Talk from the High Chair").

Question #2 asked what issues on the VAS program were expected to have the most impact on their work during 1999-2000. The top five issues are shown below, ranked by level of impact.

1. Illustration Actuary Issues

2. Regulation XXX

3. C-3 Risk Based Capital (RBC) Based on Cash Flow Testing
4. Actuarial Guideline 33 (Clarification of CARVM)
5. Proposed New Section 7 Requirements

It was a bit surprising to find illustration actuary issues at the top of the list, since the main focus of the survey was valuation issues. This result likely indicates that, in most smaller companies, the valuation actuary also serves as the illustration actuary. That trend has held true at the two smaller companies in which I have worked.

Question #3 asked actuaries to discuss their strategies for dealing with the above issues. Most responses addressed their plans in general terms without much detail. On illustration actuary issues, the first category of responses dealt with performing the required lapse-support and self-support tests. Determining affected plans and training staff were included in this category. The process was described by some as being largely manual and labor-intensive.

The second category of illustration-related responses addressed product and illustration system changes. Regulation XXX, which forced many companies to shorten rate guarantees and therefore required compliant illustrations, resulted in changes to term rates and withdrawal of UL no-lapse guarantees. One actuary commented that the illustration regulation had prompted his company to better align experience with nonguaranteed element practices in order to eliminate product cross-subsidies.

The third category addressed the actual certifications, which involved monitoring adopting states and examining new and existing products for compliance. One

person indicated that his company, which issues no new business, certifies that fact each year.

Regulation XXX elicited comments in a number of areas, the most obvious of which was testing product pricing and reserves. Term plans with guarantees longer than one year and UL plans with extended no-lapse, or secondary, guarantees were the ones most affected. The existence and impact of deficiency reserves were the primary concern.

Product redesign was the second major focus. Adjustments included shortening rate guarantees (either by refiling or withdrawing guarantee extension riders), increasing premiums, withdrawing products, and developing new plans where necessary.

Getting help from consultants and reinsurers with product development, placement and modification of reinsurance treaties, and implementation of new reserving techniques was a third response category. Determining, justifying (e.g., through Monte Carlo techniques), and documenting X-factors were related concerns, as in some cases was developing the basic mortality studies needed to validate assumptions. Updates to valuation and administration systems were also mentioned.

Other comments indicated delays in addressing the impact of XXX, due to either the regulation not yet being adopted in affected states or a lack of time and resources. Some pointed out that XXX had little impact because their companies were not operating in competitive markets.

Comments related to C-3 RBC based on cash flow testing indicated a wide range in awareness and anticipated impact. Some said they had no plans other than to determine how it affects their companies, or that they expected minor impact due to currently high RBC levels. Of those who had examined the issue more closely, one said that his company had identified some initial capital adequacy concerns and was addressing implementation of a reporting method. Those respondents expecting the most significant impact were at companies that had no stochastic cash flow analysis procedures in place. Some anticipated that a major realignment of resources would be necessary to comply.

In addition to requiring tests for compliance, Guideline 33 prompted a number of companies to purchase and implement new (or modify existing) valuation systems. Some companies that were holding full account value for annuity reserves indicated that the only work required was to test for sufficiency. Newer product features, such as nursing home riders, also had to be addressed.

Many smaller companies had no plans to address, or were not affected by, the proposed Section 7 requirements since they already do cash flow testing. One actuary indicated, however, that the proposed ratio changes could affect his company's future plans in the area of joint ventures. Guidelines 34 (variable annuity reserves) and 35 (equity indexed annuity reserves), as well as other regulatory proposals, were expected to impact only a few respondents, most likely due to the typical product mix in smaller companies.

Question #4 asked what items, other than those related to valuation, would most impact work during 1999-2000. While a wide variety of issues were mentioned, the most frequently listed items related to Y2K, technological opportunities, and regulation. Growth, service, expense control, entering new states or lines of business, and consolidation were among the other challenges facing our membership.

Question #5 asked what types of systems were being used to deal with the myriad of statutory, GAAP, and asset adequacy requirements. Generally speaking, responses were classified as either mainframe systems, vendor-supplied systems, PC or homegrown (e.g., spreadsheet) systems, or consultants. The majority of respondents indicated the use of vendor-supplied systems in every category except statutory valuation, where mainframe systems still have a slight edge. Homegrown approaches are used predominantly for the creation statutory reserve factors.

Question #6 asked actuaries to identify resources, such as Web sites or publications, that they have found useful in their work. A number of SOA meeting sessions and periodicals have provided Web site addresses and other resources of particular interest to actuaries, so I will not repeat the entire list here. The sites most often mentioned were those of the NAIC (www.naic.org), the SOA (*www.soa.org*), the ACLI (*www.acli.org*), and the American Academy of Actuaries (*www.actuary.org*). A number of professional guides, periodicals, and vendor publications were listed as well. Other resources included reinsurers and SOA meetings and seminars.

Questions #7 and #8 dealt with planned attendance at the 1999 VAS and Session #18 in particular. Questions #9 and #10 asked smaller company actuaries about their interest and their willingness to be included in a directory of peers who could call on each other to discuss new requirements, regulations, techniques, and approaches. Nearly all responded affirmatively and as a result, a directory of e-mail addresses was compiled and circulated. Since that time, several have taken advantage of this opportunity to network and share their concerns and strategies. For more information about the peer directory or any items related to the survey, please contact me at my directory address.

Rod Keefer, FSA, is associate life actuary at Erie Family Life Insurance Company in Erie, Pennsylvania, and Chairperson of the Smaller Insurance Company Section Council.

Small Talk From the Highchair
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how we might improve our efforts in the future.

The purpose of the Smaller Insurance Company Section shall be to encourage and facilitate the professional development of its members...

Before we discuss what the Section is doing, it might be useful to first identify exactly who our members are. While the typical member practices in a small life insurance company and lives and works in the United Sates, the on-line actuarial directory available at *www.soa.org* reveals some interesting statistics about our 784 constituents (note — figures were extracted in December 1999 and may have changed slightly since then).

- 22% of our members' addresses are in 38 countries other than the United States.
  (Canada – 9%, all others – 13%).

- 40% list employment type as something other than insurance organizations (consulting actuary – 30%, all others – 10%).

- 34% identify their primary area of practice as something other than life insurance (44%), general management (12%), or financial reporting (10%). Health (12%) heads the list of exceptions.

As you can see, we are a diverse group with diverse professional needs and skills. To the extent that the Section does not fulfill its purpose in your specific situation, I encourage you to get involved, as there are probably other members in similar situations.

...through activities such as meetings, seminars, and the generation and dissemination of literature pertaining to the unique problems that face actuaries employed by smaller life insurance companies.

Our Section participates yearly in the SOA Spring Meeting, Annual Meeting, and Valuation Actuary Symposium (VAS), typically by planning one to three sessions at each. The nine-member Section Council, whose names are listed on page 2, coordinates these sessions as well as other Section activities. This year we plan to host (1) a session on smaller company hot topics at the June meeting in San Diego, (2) a discussion on cash flow testing aspects and alternatives at September's VAS in Washington, and (3) a session at the October Annual Meeting in Chicago on technology and administrative systems, plus a roundtable breakfast discussion.

While our Spring Meeting presence is limited to the life product development / financial reporting meeting, we could certainly expand our future involvement to include the health/pension meeting if enough interest was expressed. Anyone who has ideas regarding future meeting topics or participation is urged to get involved.

The Section focuses on methods, techniques, and solutions that do not require the more extensive actuarial resources available to large companies.

Optimum use of minimal resources tends to be the focus of all of our Section's meeting sessions and communications. Members are encouraged to network and share ideas about how to most effectively deal with the barrage of regulatory, competitive, management, automation, and other issues that we have in common.

The Section-wide survey on valuation issues that was circulated to members last August was one such attempt to bring together the ideas of those facing similar challenges in smaller companies. The results of that survey are summarized in a separate article. Our colleagues who have insights as to the kinds of methods, techniques, and solutions listed previously, or how they might be shared more effectively, are invited to get involved.

It provides a forum where professionals working in a smaller company environment can discuss their special concerns.

If you attend one of our Section's planned meeting sessions this year, you may notice an increased emphasis on roundtable discussions. While panel discussion formats are valuable and will continue, we want to take more advantage of the opportunities we have to discuss common concerns and solutions. For example, we currently anticipate having no agenda and no recruited speaker for the Annual Meeting breakfast, so that the entire session can focus on items of current interest to attendees.

With e-mail and Web access now available to nearly all our members, I think it is imperative that we make more effective use of this potential forum as well. The "Special Interest Sections" area at *www.soa.org* contains our Section's purpose, lists the names of Council members, and includes recent issues of *small talk*. In addition, the site now includes meeting minutes of the Section Council, which typically holds four or five conference calls plus a face-to-face meeting each year, and a recent treasurer's report. E-mail "blasts" hold enormous potential for getting information to

"While our Spring Meeting presence is limited to the life product development/financial reporting meeting, we could certainly expand our future involvement to include the health/pension meeting if enough interest was expressed."

and feedback from members quickly and efficiently. If you have not already, please provide your e-mail address for publication in the SOA on-line directory.

The Section newsletter is *small talk*. Our newsletter, which is compiled and circulated twice each year, continues to be one of the most widely read SOA publications among our members. Thanks to the vision of its editor, Jim Thompson, *small talk* consistently provides current topics of relevance to a diverse membership. You can get involved in selecting and / or addressing topics for future issues by contacting Jim at his directory address.

In case you are wondering about other ways to get involved, I can think of three. The first is to consider running for Section Council. In addition to the activities above, Council members are also included on the life and finance practice advancement committees, the committee on professional development seminars, and the council of Section chairpersons. We are fortunate this year in that each Council member has taken responsibility for at least one task, so that no one has been overwhelmed by the amount of work required. The deadline for Council nominations is May 12, so if you are interested, please contact me ASAP.

The second way is to contact a Council member if there is an area in which the Section is, or you think should be, involved that interests you. Fresh ideas and an extra set of dedicated hands are always welcomed. The third way is to share your concerns and suggestions, either through meeting discussions or newsletter publication. Whatever way you choose to get involved, you will find that our Section's size and composition give you the opportunity to be heard, to have an impact, and to make a difference.

Rod Keefer, FSA, is associate life actuary at Erie Family Life Insurance Company in Erie, Pennsylvania, and Chairperson of the Smaller Insurance Company Section Council.

Minutes of the Smaller Insurance Company Section Council Meeting

Thursday, March 2, 2000, 3:00 PM EST, Conference Call

Present: Rod Keefer, Ed Slaby, Dale Hall, Lori Truelove, Jim Thompson, John O'Sullivan, Lois Chinnock, and Richard Ostuw.

Approval of Minutes of December 9 Conference Call

ROD KEEFER NOTED THAT the minutes of past section meetings and treasury reports were now on the SOA Web site under the SIC Section heading.

We briefly discussed the pros and cons of blast e-mailing the members of the Section with a set of updated news. This would cost about $10. We decided to pursue this and include in the e-mail information about the Spring Meeting, Web site information and a call for anyone interested in running for the SIC Council. Rod will be drafting the text of this and sending it to Lois.

Treasurer's Report

DALE HALL INDICATED THAT the Section has a fund balance of $15,447 as of December 31, 1999. The fourth quarter brought expenses associated with the Annual Meeting, as well as printing and mailing costs for the newsletter and Section ballots. Additional commitments include $2,500 for the SOA expense allocation project, $1,000 for library indexing, $1,500 for "The Actuary's Career Planner," and approximately $1,400 for the Annual Meeting luncheon. The unallocated balance at year-end was $10,447. Dale will be writing up this information for the next newsletter.

Newsletter:

JIM THOMPSON HAS A March 20 deadline for the May issue of *small talk*. He will be following up with some ideas from the NAIC meeting on March 9–13, including the AOMR, XXX, and the resulting ASOP for XXX. We decided to pursue reprinting a *National Underwriter* article that ran in January.

Spring Meeting

DALE HALL WILL BE facilitating our session at the Spring Meeting in San Diego. A "hot issues" session is being planned. Scott Cipinko from the NALC and Doug Robbins from Tillinghast will be speaking. Dale will be writing an article for the newsletter to advertise the session.

Annual Meeting: We will have one session and a roundtable breakfast at the Annual Meeting. Our speaker on database marketing will not be available to attend. Rod and Jim will assist in running the breakfast. The session will revolve around technology decisions that small companies face. Ed Slaby will be run this session.

Valuation Actuary Symposium

JOHN O'SULLIVAN MENTIONED THAT the SIC was reportedly holding a seminar before the meeting on September 13. This was the first we had heard of the idea. We decided that while there may be merit in hosting or splitting a seminar with another Section in the future, the timeframe was too short for this year. An interactive forum will be held for our Section at this meeting. Several topics will be discussed including new C3 RBC methods, Section 7 opinions, setting X factors, internal management and the use of consultants.

Other business

ROD KEEFER AND ED SLABY will attend the up-coming meeting of the Council of Section Chairs. We should all think of SIC Section members who would be interested in serving on the Council so we can fill our election slate.

The next meeting has been set for a conference call on May 10, 2000, at 3:00 Eastern time.

Submitted by Dale Hall
March 14, 2000

Highlights of the March, 2000 NAIC Life and Health Actuarial Task Force Meeting

by Donald P. Maves

The NAIC Life and Health Actuarial Task Force (LHATF) met on March 10 and 11 in Chicago.

Accident & Health Working Group

THIS SUBGROUP DISCUSSED THE following projects:

Medicare Supplement Insurance
The group received a report from the American Academy of Actuaries Medicare Supplement Work Group. The purpose of this work group is to analyze the underlying causes of the trend toward steeply rising claim costs. The work group indicated that this report is preliminary and that it will continue to study claim data. However, it identified outpatient claim costs as one of the contributing factors of high claim costs, and also noted that there are wide variations in claim costs by state.

LHATF discussed the creation of a subgroup of the A&H Working Group to study and revise the current structure of Medicare Supplement standardized plans.

Health Reserve Guidance Manual
The manual is intended to be a source of guidance for appointed actuaries, but it will not supercede existing laws, regulations, and guidelines. Two subcommittees of this group have been formed to resolve issues relating to conservatism in reserves and the definition of premium deficiency reserves.

Disability Income Tables
Studies of morbidity data for three lines of business are in various stages of progress. The intent is to derive new valuation tables for group DI, individual DI, and credit DI.

The group DI study is not complete, although the Academy Subcommittee has submitted a preliminary report.

The A&H Working Group voted to expose the March 3, 2000, draft of the Health Insurance Model Regulation. The model includes the new individual DI valuation table. The Working Group intends to act on the model at its June meeting.

The Academy Subcommittee reported that a credit DI basic table had been finished. The next steps include development of a valuation table from the basic table, analysis of the impact of the new table, and exposure for comment.

HMO Rate Adequacy
Regulators intend to closely monitor reserve and capitalization issues because of increased frequency of managed care organization insolvencies.

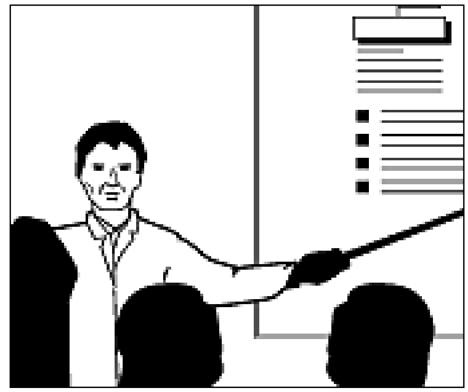
Life & Health Actuarial Task Force

THE GROUP DISCUSSED THE following projects:

Unified Valuation System (UVS)
The main point of discussion was the viability analysis and report. Some regulators were skeptical of the value of a mandated written report, instead preferring face-to-face meetings to discuss companies' information and risk profiles. Other regulators thought that written viability reports were valuable but only if received on a timely basis. They would advocate eliminating other mandatory tasks in exchange for timely written viability reports. LHATF asked for sample reports to study at its June meeting.

The Academy numerical modeling group plans to produce a seminar in the fall to present its findings on valuation, covariance, and risk-based capital.

Policy Forms
LHATF noted that there is a high level discussion in the NAIC of creating an umbrella organization for the review of life and annuity policy forms. This activity is



a response to concerns that the 50 state approach is inefficient and puts life insurers at a disadvantage relative to other financial institutions.

AOMR
The Actuarial Standards Board (ASB) has revised two Actuarial Standards of Practice (ASOP) in response to proposed changes to the AOMR. The ASB has tried to accommodate small companies by relating the level of analytics required to the riskiness of the products and investments. Nevertheless, there is still opposition within segments of the industry to asset adequacy analysis. The official exposure for the revised ASOPs should occur by June.

Variable Life
New York adopted revised Reg 147 (i.e., its version of XXX) with applicability to variable life plans with secondary guarantees.

Equity Indexed UL
LHATF adopted guideline ZZZZ for the valuation of these products.

Nonforfeiture for Products with Secondary Guarantees
LHATF spent a lot of time discussing two issues. First, should long term secondary guarantees have required cash values at all? Second, if so, then at what level?

LHATF members generally believe that the answer to the first issue is affirmative. The second issue triggered a long discussion about the viability of pricing these long-term guarantees aggressively. LHATF plans to study pricing issues thoroughly at its next meeting.

New Standard Nonforfeiture Law
LHATF spent considerable time discussing plans that have no stated method of calculating cash values except that it will be done in any manner that the company chooses. Two issues arose here also. First, should this plan type be permitted? If so, should companies be prohibited from illustrating any values at all in sales material? Neither question was answered, but if LHATF ultimately answers the latter question affirmatively, then that may imperil the illustration of dividends on par policies. LHATF plans to discuss this issue quite thoroughly at its next meeting.

Revisions to Guideline 9-A
LHATF intends to create Guideline 9-C to deal with substandard annuities. It must resolve which substandard annuities would be subject to 9-C and the appropriate level of conservatism in such reserves.

Variable Annuities With Guaranteed Living Benefits (VAGLB)
The Academy committee intends to prepare a report for the next LHATF meeting. Topics covered in that report will include details of a general reserve methodology, criteria for the Keel method to be used as a safe harbor, reserves for VAGLBs combined with minimum guaranteed death benefits, reserves for VAGLBs with significant interim benefits, and reserves for reinsurance.

New CSO Mortality Table
The Society of Actuaries' committee has nearly completed the draft basic table and is on track to get a final valuation table done by the first quarter of 2001.

Valuation and Nonforfeiture Over Age 100
An Academy committee has just been formed and will begin research shortly.

Products that Link Investment Returns to Specified Asset Pools in the General Account
LHATF has not seen many of these products. The regulators are seeking industry comments to determine the scope of this project.

Nonforfeiture for Equity Indexed Annuities
LHATF dropped this project.

* * *

The next LHATF meeting will be held Thursday and Friday, June 8 and 9, 2000, in Orlando.

***Donald P. Maves, FSA, is manager, Actuarial Services with PolySystems, Inc. in Chicago, IL. He can be reached at* dmaves@polysystems.com.**

Need Health Data?

by Tom Edwalds

Health actuaries looking for data or concerned about health data issues should check out the National Health Information Resource Center (NHIRC) Web site at *www.nhado.org*. The NHIRC is an online interactive resource for information about current health data/information projects and databases. NHIRC was created by the National Association of Health Data Organizations (NAHDO) with the assistance of grants received from the Robert Wood Johnson Foundation and the Society of Actuaries (SOA).

Publicly available NHIRC services include a hot-linked listing of health data/information related sites, a Marketplace listing of health data/information products and services, a calendar of upcoming health data related meetings, press releases posted by NHIRC users, and up-to-date information on the administrative simplification provisions of HIPAA. Password protected NHIRC services include abstracts for current health data projects, industry-related news stories from American Health Line, and a real-time chat room. Section members are authorized to access all of these areas. When the dialog box appears, enter “nhirc” for the user name and “nahdo98” for the password.

NAHDO continues to add new features to the NHIRC. Currently under development are a health database locator module, a topic indexing/search/retrieval system, and a section for project abstracts related to outcomes and performance measurement.

The NHIRC is a valuable resource for health actuaries. Check it out!

Thomas P. Edwalds, FSA, is senior research actuary at the SOA. He can be reached at *tedwalds@soa.org*

Complying with the XXX ASOP

by Douglas L. Robbins

The new line of generation-XXX term and UL products is here, and with them come questions about how to apply the model regulation in valuing life insurance policies. Although some questions might involve the new standards for basic reserves, or others the issue of contract segmentation, most tough ones involve X Factors. The Actuarial Standards Board (ASB) has addressed this topic with a proposed Actuarial Standard of Practice (ASOP).

What X Factors Can I Use?

THERE ARE TWO SETS of tests for the X Factors that companies may use to lessen valuation mortality for deficiency reserves in a product's first segment. Both sets contain two distinct tests. The first set of tests is simple and requires no analysis of anticipated mortality:

- No X Factor can be less than 20%, and
- X Factors may not decrease in successive policy years.

Subject to these rules, X Factors can be established by the actuary and may vary by factors such as policy year, policy form, underwriting class, and/or issue age. It is also important to understand that the second test applies only to a set of X Factors at a given valuation date. If, for example, a company used constant X Factors of 30% for its preferred class, and later years' analysis proved that this could be dropped to 25% on both new and inforce business, this would be allowable for the policies in force (because as an overall assumption, the 25% is also non-decreasing by duration).

The second set of tests compares X Factor adjusted mortality to anticipated mortality, without improvement beyond the valuation date. According to these tests:

- The present value of X Factor adjusted mortality must be at least as great as the present value of anticipated mortality, and
- X Factor adjusted mortality must be at least as great in each of the 5 years following the valuation date, as anticipated mortality.

The test period for these tests is limited to the first segment. The tests are straightforward, but require actuarial judgment in assessing anticipated mortality.

How Does the ASOP Suggest That I Select These X Factors?

THE SELECTION OF X Factors according to the ASOP should be based upon the best estimate of anticipated mortality. As pointed out previously, however, this best estimate should not take future mortality improvement into account — it should be based upon current experience only.

In theory, it is conceivable for a company to have only one set of X Factors for all its policies. More likely, however, even a small company will have at least a few sets of X Factors in use across its lines of business. If so, the ASOP refers to each of these as an "X Factor Class." For each X Factor Class, an anticipated mortality assumption will be needed.

X Factors should produce valuation mortality that would be expected to pass both tests in the Model Regulation, when compared against the anticipated mortality assumption. The less certain you are of your anticipated mortality assumption, the more conservative you may wish to be in setting X Factors. Otherwise, your company may be subjected to adverse accounting effects, if and when experience forces X Factors upward.

According to the ASOP, the best possible experience used for establishing an anticipated mortality assumption would be relevant company experience, if credible. If this is not available or credible, the next best sources in order of preference are:

- experience on similar types of business in the same company
- experience on similar types of business in the other companies, including reinsurance companies
- other sources of relevant experience

As a last resort, if all of the above sources fail to form a credible basis for an assumption, the actuary may use actuarial judgment in setting an assumption.

The ASOP points out that for studying relevant experience to form an anticipated mortality assumption, exposures based on face amount or units of insurance are more meaningful (from a solvency standpoint) than exposures based on numbers of policies. It also points out that when deciding on a historical study period for mortality, there is a trade-off between having enough data (which would tend to lengthen the period) and having relevant data (which would tend to shorten it).

In What Ways Will I Have to Review My X Factors as Experience Emerges?

ANY COMPANY THAT HAS at least one X Factor on any policy that is less than 100% will need to file an annual opinion and supporting actuarial report, based on asset adequacy analysis. The opinion must state that all X Factors in use meet the requirements of the Regulation, and this statement covers all policies subject to the model, not just those with X Factors less than 100%. Such policies without X Factors assigned are tested as though they have X Factors of 100% at all durations.

On the other hand, the ASOP defines policies subject to the Model Regulation as being only those that use the Model Select Factors for calculating deficiency reserves. Policies using only 1980 CSO with or without the 10-year select factors are not subject to the Model Regulation.

Because of this set of requirements, any actuary who needs to file an opinion including an analysis of X Factors must annually review experience on XXX policies as it unfolds. The ASOP states that experience should be reviewed first for each X Factor class alone, and then in aggregate across the company. If at either level, testing suggests raising the assumption, this should be done, and then the assumption retested before moving on.

Unfolding actual experience is viewed using exposure units based on face amounts of insurance, not policies. It is also viewed gross of reinsurance, according to the ASOP.

Is There a Specified Form of the Test for Anticipated Mortality?

ACCORDING TO THE ASOP, the actuary must do some sort of analysis that he or she can justify to demonstrate that assumed anticipated mortality is appropriate, in light of emerging experience. A statistical methodology seems to be suggested, but the ASOP chose to expressly state that this is not the only acceptable methodology.

On the other hand, a statistical framework is a generally accepted actuarial means of validating assumptions like anticipated mortality. This may aid greatly in terms of its being deemed justifiable, relative to other approaches.

The background section of the ASOP spends some time on some of the statistical methods available for evaluating anticipated mortality in light of emerging experience. However, this section is not actually part of the ASOP, and thus is not binding on Academy members. Some of the issues addressed in this section are Monte Carlo methods, hypothesis testing, and credibility methods.

Why Might I Need Monte Carlo Simulation?

REMEMBER THAT THE ASOP recommends that to be appropriately done, the anticipated mortality assumption should be tested in terms of face amount, not policies. At year-end, each company will have a block of policies that all have annual rates of mortality suggested by the actuary's anticipated mortality assumption. Using a Poisson or Normal approximation, it is possible to develop an explicit distribution for the number of deaths that should have occurred.

But when the testing is by face amount, there is no statistical theory for developing a distribution for a block of policies. Monte Carlo simulation makes it possible to test the actual experience of face amount paid out in death claims against the distribution of expected claims suggested by the anticipated mortality assumption. The actuary can then make an accept/reject decision grounded in analysis, as well as judgment.

"According to the ASOP, the actuary must do some sort of analysis that he or she can justify to demonstrate that assumed anticipated mortality is appropriate, in light of emerging experience."

The general idea involves assigning each policy a "q," based on the assumed anticipated mortality. One simulation would involve generating a random number between 0 and 1 for each policy, and summing the face amounts of all policies for which the random number was less than the "q." This would be the total face amount paid on deaths for that trial. By repeating this an infinite number of times, the distribution of deaths by face amount implied by the anticipated mortality assumption would be spelled out completely. In practice, some finite number of trials will suffice to tell the actuary where his actual experience came out relative to expectations.

Again, although Monte Carlo simulation could clearly be useful, the ASOP does not imply that this methodology is necessary to meet the standards imposed by the Model Regulation.

Summing Up

THE ASOP IS STILL in the exposure stage as I write this article. It is possible, therefore, that there may be significant changes to it before it becomes final. However, in any case, the XXX Model Regulation and accompanying ASOP will certainly lead to some interesting work for valuation actuaries this coming year-end.

***Douglas L. Robbins, FSA, MAAA, is a consulting actuary at Tillinghast-Towers Perrin in Atlanta, GA. He can be reached at* robbind@towers.com.**

Observations on the LHATF Meeting at the NAIC Meeting

by James R. Thompson

The Life and Health Actuarial Task Force consists of the actuaries of various insurance departments. It is the driving force behind a lot of legislation, especially the more technical variety. It has been a busy group. I attended its session on Saturday morning, March 11, at the recent NAIC meeting. It was quite instructive, with certain issues of interest to the smaller insurance companies. Two of these are the actuarial opinion and memorandum regulation (AOMR) and the unified valuation system (UVS).

The UVS was on the agenda first. This is a comprehensive revision of the total valuation process. It will be years in conceptualizing and implementing. Much research on the reserve methodology must be done. At this meeting, a significant "sense of the house" was taken on the issue of viability, which is an inherent part of the UVS.

Viability testing means testing the business as a going concern. From the viewpoint of modeling, this involves taking the in-force business and adding new production and producing a future projection (often a five-year plan). This is not always a quantitative model. In the discussion the regulators, including Tom Foley who chaired the session, generally stated that they liked to see a company management with a sense of where they were going. This did not have to be an strictly quantitative model but at least a written plan. The issue of professional standards was brought up. Should a viability analysis come under professional actuarial standards? They were inconclusive on this and felt comfortable dealing with any sort of viability analysis rather than none.

The regulators mentioned that, independent of the UVS, they would like to introduce viability under the current regulatory structure. They had discussed the UVS at the previous meeting and took a sense of the house as to doing this. The regulators seemed willing but they mentioned that the industry seemed opposed.

Currently, if a company fails the RBC (Risk Based Capital) analysis by some margin, it must submit a business plan. So, in a sense, some companies must do a viability analysis. The ACLI said they reserved judgment on whether to require viability under the UVS but opposed it under the current regulatory system. This difference of consensus between the regulators and the industry was noteworthy. This carried over in the discussion of the AOMR.

The AOMR followed. One interesting item is that the old Examiner Team concept has been removed by the NAIC and replaced with the Analyst Team System (ATS). This affects the AOMR because one of the items the actuary must opine on is whether he knows of any action by the Examiner Team. Thus this change must be incorporated into the AOMR. The ATS involves some cooperation among examiners but more significantly, it involves them cooperating with each other but not telling the companies how they stand. Currently if they give a company a bad rating, the company knows about it. I find this feature a significant change in relations with the regulators. We should investigate this further and be prepared to comment on it and deal with it.

The new AOMR will get rid of the smaller insurance company size criteria for exemption for the asset adequacy analysis. At the same time it will not mandate the form of the analysis and the currently seven prescribed scenarios. They mentioned that this had been on the table for two sessions. The regulators have not received comments on the AOMR and it has been accepted by the task force without a formal adoption vote. They are looking to June for formal adoption.

The LHATF discussed the Actuarial Standards of Practice which would apply to this revised AOMR. There are currently three — 7, 14 and 22. Since 14 deals with when to do cash flow testing and since the new AOMR will eliminate the exemptions, they eliminated 14 and incorporated some of it in 7 and updated 22 (updated February 11).

They explained the process. The task force develops the initial drafts of the ASOPs. Then this goes to the Life Committee of the American Academy of Actuaries. This committee can make changes without the approval of the task force. Then this is sent to the Actuarial Standards Board, which likewise can make changes without the approval of the Life Committee. This is then exposed for several months. If there are serious comments, the entire process can begin again. The new ASOPs are supposed to take care of various comments about the earlier ones and to be more completed and comprehensive.

There were some time for comments from nonregulators. Bill Schreiner of the ACLI said that his organization sent surveys to about 200 smaller companies (defined as having less than $500 million of assets). About 120 replied, of which 44% were Section 7 companies (never doing asset adequacy analysis), 12% did it every three years, and 44% did it annually. About 90% of the Section 7 companies disapproved of the new AOMR and 40% of the ones that did it annually. The regulators expressed skepticism as to the significance of this because of changes in the ASOPs which make it easier in some ways for companies to comply. They wanted to see a copy of the survey form.

Jim Van Elsen, a consultant who has frequently expressed the viewpoints of smaller companies, said that based on extensive conversations with managements, he feels they would be quite willing to spend time to oppose the new AOMR. Smaller companies do not see the cost of it as being of value.

The National Alliance of Life Companies spoke against it and said that they plan to use the meeting of the A committee (overall life committee of the NAIC). Their members felt there was no demonstration that additional testing will solve or prevent any problems.

The National Fraternal Congress of America (NFCA) said they had five members with more $1 billion in assets and 60 with less than $100 million. Their members perceived the new AOMR as more costly. Even though the mandatory scenario testing is eliminated, they still perceive that the actuaries will tend to be conservative and be more "professional," that is, do more work to comply. Thus they see the professional standards as causing more work than anticipated.

I recently attended a meeting of the NFCA and it was mentioned there that the cost of regulation is perceived as eating the smaller fraternals alive. They perceive the increased regulations as an impediment to putting their energies into developing new business. Most fraternals are not in risky products. They are small, with small staffs and need to sell more policies to lower their per policy cost. Regulation is perceived as onerous.

Thus again we see the pattern that the regulators are developing a feeling of comfort with an issue and the industry is expressing opposition. We should be aware that the June meeting of the NAIC will be decisive. Even though there is some lobbying against these developments now, smaller companies should be aware of the apparent seriousness of the NAIC in acting at the June meeting.

I have followed these discussions and read the drafts. I understand the issues. The regulators have reasons for making the regulation more professional. The discretion involved in testing appears to make sense and allow the use of prior studies. I find the perception of the smaller companies to be similar to what many people have of the federal spending programs. The government claims to be able to solve a problem with some resources, and they try to persuade the taxpayers to put up with it. Past extravagances come back to haunt the government. Taxpayers develop a distrust of Congress and vote no. I see this same effect developing. The companies will not trust the regulators when they claim to be saving them money. There is a real perception problem here. Perhaps the companies are right. What is your perception? If you want regulation, just sit tight and say nothing. If you want to participate in deciding your fate, there will be plenty of need for volunteers to assist industry organizations from the NAIC meeting.

The NAIC is even giving you an incentive to come. They are holding the June meeting at World Disney World Dolphin Hotel in Orlando, Florida, June 10 – 14. So come and bring the family for some lob-bying and sun and fun.

***James Thompson, FSA, is a consultant with Central Actuarial Associates in Crystal Lake, Illinois, editor of* small talk, *and a member of the Smaller Insurance Company Section Council. He can be reached at* jrthompson@ ameritech.net.**

"Thus again we see the pattern that the regulators are developing a feeling of comfort with an issue and the industry is expressing opposition."

NEWSFLASH!!

The Valuation Task Force of the American Academy of Actuaries will be meeting May 1 and 2 in Chicago beginning at 9 am. It will discuss Viability Analysis and Modeling Issues.

This is in response to a charge from the NAIC. Because of the position LHATF took on Viability at the March meeting, this is an important meeting for small companies. Although only about a dozen actuaries are on the Subgroup on Viability Analysis, the meeting is open and comments from the floor will be part of the process.

Smaller Insurance Company Section Council Meets at the 50th Annual Meeting in San Francisco

Planning for the new year, Smaller Insurance Company Section Council members met at the Annual Meeting in San Francisco back in October of 1999.
L to R: Stephen Marco, Ed Cowman, Dale Hall, Lori Truelove, Ed Slaby.
Participating by phone: Rod Keefer, Norm Hill, Paul Retzlaff.

Treasurer's Report

by R. Dale Hall

1999 Smaller Insurance Company Section Treasury Report

1999 WAS ANOTHER SOLID financial year for the SIC Section of the SOA. The fourth quarter began with a fund balance of $19,622 which helped us successfully meet our expenses of the Annual Meeting. Revenues for the fourth quarter were approximately $400, which arose from dues from a few new members and interest on our fund balance. Expenses for the fourth quarter totaled $4,500, most of which arose from our expected Annual Meeting expenses, including our hosting of the Section luncheon. Other significant expenses included the printing and mailing of our fall newsletter and our Section election ballots.

The Section closed 1999 with a total fund balance of $15,447. $5,000 of this balance is committed to SOA projects such as the development of a new expense allocation table, library indexing, and production of "The Actuary's Career Planner." This leaves us with an unallocated fund balance of $10,447 to plan events for another successful year ahead in 2000.

R. Dale Hall, ASA, MAAA, FLMI, is director of Financial Reporting and Asset/Liability Management at the Midland Life Insurance Company, Columbus, Ohio. He can be reached at dhall@themidland.com.

A Message from the President-Elect...Think *NAAJ*

by Rob Brown

As the 1999-2000 president-elect, I recently chaired my first Council of Section Chairpersons. Even before this meeting, my impression of the Sections as the SOA leadership's main connection to the grassroots of this organization was that your contributions are vital to advancing the profession. And, I came away from the meeting even more impressed with the heavy lifting the Sections do. Your hand on the pulse of your practice area assures solid continuing education content for our meetings. Your focused publications and sponsorship of relevant research and other SOA projects are hitting the mark for our members.

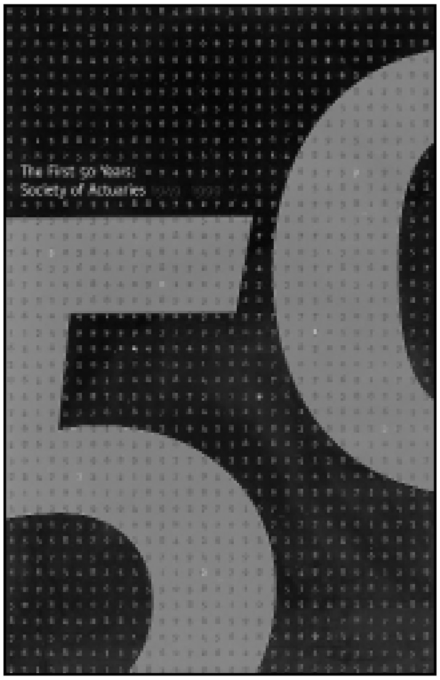
I am especially impressed with your publications. I receive — and read — copies of all the Section newsletters, plus the commemorative monographs produced by the Sections for the 50^{th} Anniversary. What a volume of work, pertinent to so many practicing actuaries! My immediate thought was that much of this material is worthy of going to review for the *North American Actuarial Journal (NAAJ)*.

WHY THE *NAAJ?*

The *NAAJ* is the premier publication of the Society of Actuaries and its only refereed journal. Two myths about the *NAAJ* are 1) that it is only seeking scientific research done by Ph.D.s, and 2) that if an article has already appeared in another publication it can't be published in the *NAAJ*. In fact, from the beginning, the *NAAJ* has hoped to have a mix of scholarly, scientific papers, articles practical for today's practicing actuary, and wider topics that would appeal to nonactuarial readers. The "Guidelines to Authors" in the *NAAJ* states that "In general, we are looking to publish papers in the *NAAJ* that provide a springboard for the further development of education, research or improved practice." Much of what I see in the Section newsletters certainly meets that criterion, and I believe would have a good chance of being accepted by the *NAAJ*. The only truth to the second myth is that you cannot submit an article that has appeared in another refereed journal or that is copyrighted by another organization. Articles in other SOA publications are certainly eligible.

Many practicing actuaries today have limited time to write articles and may think the *NAAJ* process is too daunting. But, I've been through the process, and it is relatively painless. Why not look through what you've written for Section newsletters or *The Actuary* and consider submitting your best work to the *NAAJ?* You can find guidelines on the SOA Web site under "Publications" or you can request them from Cheryl Enderlein at 847/706-3563.

Still reluctant? Give me a call at 519/888-4567, ext. 5503, or e-mail me at *rlbrown@math.uwaterloo.ca* and we'll talk. Let the profession share your valuable insights.



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