

Thursday, September 11, 2003: Life & Health Actuarial Task Force – Accident & Health Working Group

The quorum of regulators present were from AR, AK, FL, IL, MN, NE, NM, NY and TX.

Reserving Standards for Long Term Care Insurance. This was the meat of the entire day. Regulators are seeking to update the requirements in the Health Insurance Reserves Model Regulation on morbidity, mortality and persistency assumptions. The morbidity changes being sought relate to the use of morbidity improvements projected to occur after the valuation date. These changes have been under discussion for the better part of 2003. New language for the model regulation has been in development for several months. Several provision changes had been proposed prior to this meeting:

- The prohibition of morbidity assumptions that project improvements in morbidity not yet recognized as of the date of valuation. This provision would be retroactive unless explicit approval is received from the insurance commissioner of the state of domicile.
- The introduction of maximum lapse rates by duration.
- The imposition of a minimum standard for the level of provisions for adverse deviation (PADs).

Further changes, pursuant to discussions on the last A&HWG conference call, were:

- The elimination of assumption-specific PADs in favor of a PAD only on the reserve in aggregate.
- In addition to the previously-agreed-upon absolute limits to permissible lapse rates, the requirement that lapses not exceed 80% of the pricing lapse assumption.

No changes to the mortality provisions have yet been agreed on, but discussions are ongoing.

Subsequent to a motion to expose the newest changes, the following comments were raised:

A&HWG

- John Hartnedy (AR) expressed concern that the committee was moving on these issues too quickly without knowing the impact of the changes proposed.
- Frank Dino (FL) countered that it was unwise to wait when evidence – primarily substantial recent rate increase activity – suggests that there is a current and potentially serious problem with current standards.



Industry/Interested Parties

Bill Carroll representing the American Council of Life Insurers (ACLI) and Bill Weller representing the Health Insurance Association of America (HIAA) offered similar comments:

- In general, the industry does not oppose the changes being proposed except as noted in the following:
 - The industry opposes the 80% of pricing lapse rate restriction on the grounds that it imposed a PAD on the lapse assumption. It was pointed out that the working group had agreed to eliminate requirements for assumption-specific PADs and that this new provision would impose redundant conservatism.
 - The industry strongly opposes making the new requirements retroactive on the basis that the impact could be devastating for many companies.
 - Although no changes have yet been proposed to the mortality standard, among the options previously discussed is to update to the 2001 Individual Mortality Table. The industry strongly opposes the use of an individual annuity table.
- Burt Jay, representing the American Academy of Actuaries (AAA), distributed and reviewed the outline of an AAA project to study the impact of the recommended changes to the reserve standards on both reserves and pricing.

Subsequent to these discussions, the working group approved the motion to expose the proposed changes to the Health Insurance Reserves Model Regulation with Arkansas casting the only dissenting vote.

Medicare Supplement Premium Refund Project.

This discussion centers on two items:

- A proposed change in the premium refund formula.
- Use of some aggregation across plans and states rather to deal with non-credible blocks of business. Katie Campbell (AK) noted that in Alaska they would likely never have a credible block of business.

Since this proposal purports to change federal regulation, it was agreed that the draft would be distributed without declaring it as a formal position of the A&HWG or the NAIC.

Medicare Supplement Automatic Claims Filing Fee.

The A&HWG was asked by the Medicare Supplement Working Group (MSWG) to opine as to whether such fees are properly classified as premium or as an addition service fee outside of premium. Some among the members of the working group expressed



frustration with the lack of a mandate for this item. Minor changes were recommended in the proposed draft response with the intent of forwarding to the MSWG on completion.

Long Term Care Redux.

This item was not included on the agenda. The working group asked the AAA to report on its study of the Long Term Care Experience Exhibit. The AAA proposed several changes to the document that sought to focus the reporting emphasis on trends over recent periods at the expense of cumulative inception-to-date data. Frank Dino (FL) objected. The working group requested that the AAA modify its proposal to address the concerns expressed.

Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses.

The A&HWG was asked by the Emerging Accounting Issues Working Group (EAIWG) to consider a revision the Claim Reserve section of the Health Reserve Guidance Manual (HRGM) to be consistent with Interpretation 02-21 *Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses*. Julia Philips (MN) drafted language in June to amend the HRGM. Despite concerns expressed by Bill Weller (HIAA) that the language would lead some to treat capitation situations in indemnity contracts differently than in managed care contracts, the working group voted to send the response to the EAIWG as is.

Schedule O Clarification of Other Accident and Health Lines of Business.

Dennis Hare (NAIC Staff) presented his study on the prevalence of company use of the Other Accident and Health sections in Schedule O, finding that 30 companies had reported data. At issue is a clarification of the lines of business that should be included in that section.

Chairman Michael Batte (NM) requested that a memo be drafted to present the study's findings for discussion at the December meeting of the working group.

Credit Disability Valuation Standards.

In June, a draft revision to the Health Insurance Reserves Guidance Manual was proposed to exclude single premium credit disability insurance from unearned premium reserve requirements. After brief discussion, agreement was reached on minor changes to the proposed draft. The amended draft was adopted without dissent.



Revisions to the Health Blank and the Life/Health Blank to Achieve Greater Consistency

There was lengthy, though not contentious, debate on technical issues relating to the reporting categories in each blank to bring them into uniformity. As it was determined that the draft changes could not be forwarded to the B Committee without full instructions, Julia Philips volunteered to chair a subgroup to write the instructions, a draft to be exposed to the working group members prior to the December meeting.

Consistency in HMO/HMDI Reserves

At issue are premium deficiency reserves. Both Randi Reichel (American Association of Health Plans) and Donna Novak, representing the AAA, presented memos addressing the issue and attempting to clarify the purpose and nature of premium deficiency reserves.

After minimal discussion, Julia Philips agreed to chair a subcommittee, including John Rink (NE), Katie Campbell (AK), and Michael Boerner (TX), to study the issue further.

Reserving Standards for Disability Income Insurance

A proposal to modify minimum morbidity standards in the Health Insurance Reserves Model Regulation was submitted to the group in June. After minimal discussion, the working group adopted the revised language without dissent.

Update on AAA Health Insurance Rate Filing Task Force

Joanna Ossinger, representing the task force, reiterated an invitation to the working group to attend a webcast to present their model of the individual market and to be used in most of the ensuing analysis relating to this issue.

Charges for 2004

A number of minor changes were proposed during brief discussion. The health-related charges, as amended, were approved by the working group without dissent.

Friday, September 12, 2003: Life & Health Actuarial Task Force

Members present were AR, CA, CT, FL, IL, MN, NE, NM, NY, PA, NY and OK. Larry Bruning of KS, not a member, also attended.

Approve Minutes. LHATF approved the minutes of the last meeting and of the five conference calls since then.



Topics Pertaining to Nonforfeiture for Individual Deferred Annuities. LHATF discussed implementation issues related to the recently passed Model Law. Bruning (KS) outlined technical questions related to the determination of the CMT rate, the determination of the 15-month period, contract specifications if there is no reset, the determination of the present value of paid up annuity additions and the interest rate permitted for demonstrating compliance with Section 6 of the Model.

Eric Carlson and Andrew Erman reviewed the AAA Annuity Nonforfeiture Implementation Work Group's draft. The draft identified four considerations related to the determination of the initial interest rate:

1. Flexibility in changing the methodology,
2. Frequency of determination,
3. External (i.e., regulatory) validation, and
4. Use of "value-triggered" methods (e.g., the rate does not change if the CMT stays within a given range of values).

The draft also listed options for rate disclosure:

1. Specify the exact method in the contract,
2. Specify the exact method in the actuarial memo,
3. Do not disclose the method, or
4. Disclose any changes in an informational filing to regulators.

LHATF split about equally on #1, 2 and 4.

The AAA draft also proposed two alternate approaches for equity-indexed annuities. The first, called a cost basis approach, is based upon guaranteed product features. AAA enumerated 8 alternatives for determining the discount rate under this approach, but indicated that it prefers the 5-year CMT without spread.

The second approach is called a market value approach. It is based upon current product features, but otherwise is similar to the first approach. AAA intends that both approaches would be available to companies, who would choose at the time of filing.

With all of the issues outlined above there was remarkably little feedback from LHATF, but in fairness to the regulators they had seen the issues for only a very short time before the meeting. Also no other interested parties commented.

LHATF will schedule a conference call before December to provide feedback.



General Nonforfeiture Project. AAA Nonforfeiture Improvement Work Group is considering three issues that must be solved to present a recommendation. They include the identification of principles, the development of a structure and the identification of income tax issues.

The AAA Work Group also asked for guidance from LHATF on four issues:

1. Lines of business to be included in the scope,
2. Equity based on prefunding (i.e., a defined formulaic approach) versus mere disclosure of optional benefit structures,
3. Treatment of non-guaranteed elements, and
4. Current areas of the SNL that need to be fixed.

Some discussion ensued, but LHATF provided no definitive answers. Bill Koenig remarked that there is little enthusiasm for this project on the ACLI Actuarial Committee. Bruning stated a principle that once an amount is credited to a contract, it should never be forfeited. When asked if this precluded market value adjustments, he said no.

AAA Work Group will continue its deliberations and report at the December meeting.

Variable Annuity GMBD Reserves. The focus of this project is to determine the appropriate way to account for partial surrenders in which relatively large death benefits remain compared to account values – the so-called “dollar for dollar” option.

Industry objects to the assumption of 100% utilization, arguing that that is not reasonable based upon historical results. LHATF subgroup (CA, FL and NY) proposed a guideline that would still require AG 33 and AG34 to apply, but if the result is redundant reserves, then in essence a minimum 20% utilization would apply in determining partial withdrawal benefit streams.

AAA proposed a number of alternatives. The two that were discussed included:

1. Revise AG33 and AG34 to require asset adequacy analysis for the entire VA contract, considering future elections of the “dollar for dollar” option in the analysis. AG33 would apply to VA, but not to GMBD.
2. AG33 would not apply to VA and AG34 would have an explicit formula for reserves for the “dollar for dollar” option.

Dino (FL) argued that AG33 should not exclude VA. NY argued for a floor assumption on reserves. After much discussion LHATF agreed to leave AG33 unchanged and change AG34 to require asset adequacy analysis that must consider future partial withdrawal activity. The analysis would apply to the entire variable annuity contract. It is possible that this separate analysis could be required for year-end 2003, but it is not



clear what companies will have to do with the separate analysis for statutory, tax, or reinsurance.

Update on C-3 Phase II Work and VAGLB Reserves. AAA Variable Annuity Reserve Work Group asked for guidance in five areas:

1. Form of regulatory response (guideline vs. regulation vs. law),
2. Application to in force business,
3. Level of reserves and reserve methodology desired,
4. Time frame needed, and
5. Response to any issues raised by RBC Working Group.

LHATF approved the Work Group's drafting of a guideline and recommendations that will be the basis of discussion at the December meeting. The intent is to have this proposal be the long-term solution effective for December, 2004.

Possible Areas of Revision to the Standard Valuation Law. LHATF voted to eliminate the requirement for certificates of valuation if and when the SVL is ever changed. There was little other discussion of this topic, although LHATF once made an extensive list of issues to be addressed.

Credit Insurance Mortality. A LHATF subgroup (MN, NM, NY and TX) was appointed to investigate appropriate reserves for Monthly Outstanding Balance credit life insurance and to report at the December meeting.

Request from Financial Analysis Handbook Working Group. LHATF was asked to comment on the utility of certain formulaic tests used by state examiners. LHATF agreed that the tests had outlived their time and should be eliminated because most companies perform the much more useful asset adequacy analysis.

Model Laws Review. The NAIC Executive Committee had requested that LHATF review some models to recommend either deleting, amending, or keeping with no change. LHATF recommended no substantive changes.

Need for Revision to the Life Insurance Illustration Regulation. An AAA Illustrations Work Group was asked to research the use of flat multipliers in setting the mortality assumptions. This could result in the inadvertent use of mortality improvement, which the regulation does not allow. The Work Group is working on sessions at some 2004 SOA meetings to discuss the issue, and a revision to the Illustration Practice Note.

2004 Charges. LHATF approved 5 "essential" projects and 10 "important" projects for 2004. The essential projects include support for other NAIC committees, a regulation for the SNL for Individual Deferred Annuities, reserves for VAs with GMBDs, reserves



for VAs with other guarantees and review of the Generally Recognized Expense Table for the Illustration Regulation.

The “important” projects include most of the remaining projects discussed in this report.

Other Matters. LHATF will schedule a conference call to discuss term products with Return of Premium benefits, specifically the lapse-supported nature of the risk and whether companies are properly applying the SVL and the SNL to this product.

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