

LHATF Feedback to the AAA VARWG Report on Variable Annuities

LHATF members on the call included AR, FL, IL, MN, NM, NY, PA, and TX . Others on the call were non-member states NJ and NC and about a dozen interested parties.

The purpose of the call was to provide feedback to the Variable Annuity Reserve Work Group (VARWG) relative to its report on variable annuities. The VARWG was formed in January 2003 as a work group of the AAA's Life Practice Council (LPC). Its charge is to examine issues surrounding the development of a reserve methodology for variable annuity products that uses the principles of the proposed Risk-Based Capital (RBC) C-3 Phase II approach. The scope of the project has not yet been determined. The question remains if it should apply to variable annuities with guaranteed living benefits, variable annuities with any guaranteed benefit, or all variable annuities. It will not consider variable life at this time.

This approach is being considered for two primary reasons.

- 1) The LPC has held the position that a long-term model-based solution that addresses both reserve and RBC considerations is a methodology that is well suited for the risk profile of variable annuity products with guarantees
- 2) LHATF has expressed broad support for this approach which was discussed during the April 25, 2002 LHATF conference call when the task force rejected the prospective Variable Annuities with Guaranteed Living Benefits reserve approach originally proposed in draft Actuarial Guideline MMMM.

During the call the report that was presented in March was reviewed. There were five key categories.

- 1) Potential Regulatory Form of the Requirement (Law vs. Guideline)
 - a. Issues include
 - i. New reserve concepts / methods
 - ii. Consistency with current CARVM
 - b. Practical Issues
 - i. Speed to implement
 - ii. Uniformity in states
 - iii. Retroactivity
 - iv. Subsequent modifications

The original report did not consider the option of a model regulation, this was raised as a question and it was agreed that it would also be considered as an option.

- 2) Reserve Methodology Issues

An appendix listed issues that need to be considered. The closer the method is to RBC C-3 Phase II the less additional work it will require.

- 3) Tax Reserve Issues



The work group plans to examine in detail any conflicts this approach will have with current tax laws.

4) Reserve Methodology Modeling

Reserve methods ultimately proposed will need to be analyzed under a broad range of interest rate, fund performance, and benefit status assumptions. The process of reserve testing can likely be accelerated by combining the efforts of the VARWG with those of the Life Capital Adequacy Subcommittee's C-3 Work Group.

5) Professional Issues

The proposed RBC C-3 Phase II approach will introduce new techniques into the reserve process. There will be a need for professional and practical guidance including some combination of a new actuarial standard of practice, the establishment of new qualification standards, and new life practice notes.

LHATF members were asked if the VARWG should continue to proceed. It was estimated that it could take anywhere from two to five years to implement depending on the commitment of LHATF. Not all members responded. AR, TX and FL indicated that they would like to see the group continue. NY expressed a preference for a formulaic approach, but not the Keel method. NY acknowledged that their preference was not consistent with what was agreed with last April but that after discussions within the department, this was their current position.

Reasons for NY's position included:

- 1) Tax Issues – requires a formulaic reserve
- 2) Reserve should be consistent with other types of reserves which are formulaic
- 3) Opinion that formulaic reserves would be less volatile
- 4) Concern with leaving the reserve adequacy up to the discretion of one person.

FL agreed that the tax issue needed reserves at a policy level and proposed using modeling to support formulaic reserves.

It was determined that VARWG should continue based on a count of 3 to 1.

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