

Life Risk Based Capital Working Group, Joint Subgroup Conference Call

This was the third of three conference calls to discuss regulatory issues pertaining to the C-3 Phase II and the variable annuity reserves work.

Various regulators and interested parties were present. Dennis Lauzon (NY) led the call. The agenda items of this particular call were: 1- finalize a mortality assumption recommendation, 2- discuss the return assumptions, 3- discuss the use of a floor scenario, and 4- discuss a letter received from the ACLI.

Item 1 – NY will make the following recommendation regarding the mortality to be used for calculating RBC and Variable annuity reserves:

- A) For formulaic factor calculations, 100% of the 1994 Variable Annuity MGDB ANB should be used. Additionally, age set back to male factors would be allowed for females.
- B) For modeling, the mortality assumptions used in modeling reserves and or risk based capital under the proposed methodology should be based on expected mortality with a margin for adverse deviation, but not less than 85% of the age nearest birthday 1994 Variable Annuity MGDB Mortality Tables.

Item 2 – Return Assumption

- A) It was noted that calibration points used for the RBC return assumptions assume an average return was 12.5%.
- B) Some felt uncomfortable with this assumption. It may be difficult to explain to an outside party.
- C) The average return is just one of six parameters that was used to fit a model to the 50 years worth of monthly returns of the S&P500. The main point is that the model used develops sufficient risk in the tails.
- D) If you change the return assumption, other parameters would need to change as well.
- E) CT is uncomfortable with long-term average greater than 9-10%.
- F) No alternatives were suggested.

Item 3 – Floor Scenario

- A) NY has proposed using a floor scenario as a minimum for RBC and reserves. They are trying to get the discussion started.
- B) What should be the specifics of a floor scenario?
- C) NY recommends a 30% drop followed by a 5% net return.
- D) Could have the rate follow the treasury so it could increase
- E) The current proposed floor scenario does not reflect taxes or expenses
- F) Could require a minimum reduction for M&E charges
- G) Discount rate could use the swap rate curve, or a fixed valuation rate, or it could tie to a treasury rate.



- H) The proposed floor scenario could provide a level of comfort for regulators.
- I) The floor scenario would be required for both the modeling and formulaic factors.
- J) The floor scenario would be calculated on a seriatim basis.
- K) Some expressed concern that the floor scenario would not handle estate riders or VAGLB ratchet benefits. Would a mirror return be assumed for these products?
- L) Assets could be incorporated. Hedges would be deemed sold immediately after the drop.
- M) Fixed accounts could be projected at the guarantee or the current rate.
- N) Some suggested a smaller drop with no recovery, or a less severe drop with a delayed recovery?
- O) Single scenario is meant to be a stress test. Something to do quickly and easily.
- P) Should all funds drop the same or should we mimic the g34 classes?
- Q) Academy is looking at this, and will come up with a recommendation after the December meeting. In the view of the Academy, the floor should be simple and straightforward and should not be overly conservative so as to make the modeling mute.

Item 4 – ACLI letter – Bill Schreiner

- A) Addressed 3 things:
 - a. Using a 3-year phase-in that ultimately continues to combine current and prior results could mute the volatility of results.
 - i. Year 1: 20% new + 80% prior
 - ii. Year 2: 40% new + 60% prior
 - iii. Year 3: 60% new + 40% prior
 - b. Dates for the basis of the data should be the same as for cash flow testing.
 - c. If the reserves exceed the capital requirement an adjustment should be made to the capital requirement in order to prevent redundant capital requirements.
- B) NY wants phase in for RBC.
- C) NY is uncomfortable with smoothing. The number is what it is.

Additional discussions will be scheduled after the December NAIC Meeting.

Tim Gaynor, FSA, MAAA

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