

Monday, April 21, 2003: Life & Health Actuarial Task Force

The Life and Health Actuarial Task Force (LHATF) held a conference call on April 21, 2003 to discuss statutory reserving issues for variable annuities (VA) with contractual guaranteed minimum death benefit (GMDB). In particular, this conference call focused on the effect of partial withdrawal on guaranteed death benefits. Currently, some variable annuities offer dollar for dollar (\$-for-\$) reduction in death benefit for partial withdrawals (PW). The participants included regulators from various states, the American Council of Life Insurers (ACLI), and interested parties from the life insurance industry.

Discussions centered around:

1. There was an article published in the *Wall Street Journal* regarding variable annuity contractual guarantees such as GMDB and guaranteed minimum income benefits (GMIB). The article highlighted the attractiveness of the GMDB under an adverse equity market scenario when the contract offers the \$-for-\$ reduction in death benefit for PW. Policyholders may anti-select the insurance company and obtain life insurance coverage at a very attractive premium rate.
2. Currently, all insurance companies selling VA are required to establish AG 34 reserve for GMDB. The scenarios used are different from the scenario suggested by the *Wall Street Journal* article.
3. If each insurance company selling VA with such a product feature is required to establish AG 34 mortality reserve under the anti-selection scenario, the resulting AG 34 reserve would be significantly increased.
4. NY indicated that NY Regulation 151 covers such a potential elective anti-selection scenario. Accordingly, NY's current position is that insurance companies should establish such mortality reserve. However, NY would like to work with other LHATF members to resolve this issue.
5. CA contacted at least one insurance company to obtain information on potential reserve increase. Currently, CA considers such anti-selection scenario within the scope of scenarios under AG 33.
6. CT indicated that it has been aware of the issue since 1994. However, no action was taken to enforce such issue. Ignoring this reserve issue is not acceptable. Setting up the entire reserve is also not practical because it may lead to unwarranted financial hardships on most companies.



7. According to representatives of the life industry, prior experience indicates that such anti-selection activities are immaterial. According to regulators, prior history should not be used to justify the current practice.
8. Regulators from IL, UT, and MN agreed that the scope of elective benefits under AG 33 includes scenarios that are composed of elective and non-elective benefits.
9. An interested party indicated that AG 33 provides guidance on scenarios that are combinations of elective and non-elective benefits. According to AG 33, the Valuation Actuary should use judgment in making determination in cases where it is not clear whether some benefits are elective or non-elective.
10. MA questioned why actuarial firms and accounting firms that issue actuarial opinions on asset adequacy reserve for many insurance companies never mention issues relating to this \$-for-\$ scenario. MA asked all parties to review this issue in its entirety (that is, not just doing the literal reading of AG 33) and to evaluate whether resolving this issue would lead to unintended consequences.
11. Significant reserve increases might lead to domestic companies ceding the GMDB risk to off-shore reinsurance companies that are not subject to domestic reserve requirements. The end result would lead to passing money around without solving the issue.
12. According to an interested party, CARVM is probably not the best reserve methodology for annuities. It is possible that there are many other product features that were offered with unanticipated scenarios. The Variable Annuity Reserve Work Group is working on a new annuity reserve methodology that may solve the issue.
13. An interested party argued that Standard Valuation Law (SVL) focuses on the greatest present value of future benefits and that one should not use wordings in actuarial guidelines to over-rule the intent of the SVL.
14. An interested party reminded regulators that many companies are aware of this product feature and have been writing policies with pro-rata rather than \$-for-\$ reduction in death benefit for PW.
15. The general consensus is that the required reserve, if any, for this anti-selection scenario should be consistent with the economics of the underlying risk.



LHATF members and other interested parties agreed to study this issue further in subsequent conference calls.

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