

Variable Annuity GMDB Reserve (Dollar for Dollar)

The Life and Health Actuarial Task Force (LHATF) held a conference call on August 27, 2003 to discuss reserve methodology for variable annuities with GMDB provision that provide for dollar-for-dollar reduction in death benefit on partial withdrawals. The participants included regulators from AR, CA, CT, FL, IL, KS, MN, OK, NY, PA, and UT as well as interested parties from the life insurance industry such as ACLI, insurance companies and accounting firms.

Items discussed were:

1. LHATF has expressed concerns regarding the reserving for GMDB which allows dollar for dollar reduction in death benefits on partial withdrawals.
2. The American Academy of Actuaries (the Academy) prepared a document outlining the background of the issue as well as the long-term solution currently studied by the Variable Annuity Reserve Work Group (VAWRG) and several interim solutions. The Academy's proposed course of action is to continue the pursuit of the long-term solution while using one of the interim solutions as a temporary method to develop appropriate reserves.
3. One regulator wanted to know more about the long-term solution before deciding on the interim alternatives. The Academy provided a brief description but also suggested that VARWG should be the entity to provide more details on the long-term solution to the LHATF.
4. The ACLI also prepared a letter to the LHATF describing the survey on potential impact of the "onerous" assumption of 100% utilization of the maximum withdraw provision on GMDB reserve. The survey on the impact was based on insurance companies' reserves as of December 31, 2002. The survey indicates that GMDB reserves, based on the 100% utilization rate, increase from 150% to 600% with the upper range figures more common. In some cases, the December 31, 2002 reserve increase would be in excess of \$1 billion.
5. There are four proposed interim solutions:
 - Interim Alternative I – Make no changes to AG 33 and 34
 - Interim Alternative II – Revise AG 33 and make no changes to AG 34
 - Interim Alternative III Option A – Revise AG 33 and AG 34 with an asset adequacy analysis requirement (for the entire variable annuity contract)
 - Interim Alternative III Option B – Revise AG 33 and AG 34 with an asset adequacy analysis requirement (consideration of the adequacy of total company reserve with



Interim Alternative IV

an explicit disclosure and discussion of this benefit in the memorandum)
- Revise AG 33 so it does not apply to variable products with this GMDDB feature and revise AG 34 with an explicit formula

6. LHATF rejected Interim Alternative I in June 2003 and consequently was not further discussed in this conference call.
7. Interim Alternative II proposes to (a) revise AG 33 such that it does not apply to variable annuities, (b) revise AG 33 so that it does not apply to the calculation of reserve for GMDDB with \$-4-\$ provision, or (c) indicate the intent of AG 33 was to address fixed annuities only. The disadvantages of this alternative are: (i) the interim solution is ambiguous, (ii) no guidance is provided for withdraw election rates, and (iii) it may have unintended consequences for other variable products and their particular elective benefits. LHATF did not discuss Interim Alternative II in detail during the conference call.
8. Interim Alternative III Option A focuses on the reserve for the entire variable annuity contract rather than just the GMDDB reserve. Option B focuses on the adequacy of the total company reserve. As Option B allows aggregation of results for variable annuities and other contracts, one regulator questioned whether Option B lead to immaterial reserves for GMDDB with the dollar for dollar provision.
9. Interim Alternative IV requires an explicit formula to calculate reserves for GMDDB with the dollar for dollar provision. However, the explicit formula is undefined and considerable work is required to develop such formula. The Academy indicated that this alternative does not reflect use of hedges as could be done through asset adequacy analysis of the total company reserve. One regulator questioned on whether such hedges exist and whether companies are currently using hedges to protect themselves.
10. The ACLI proposed a new interim alternative. The ACLI proposed to modify the language in AG 34 such that AG 34 only applies to the current account value as of the valuation date. In other words, there are no withdraws at the valuation date. LHATF did not discuss this alternative in details during the conference call.
11. One regulator suggested to leaving AG 33 alone and that companies should calculate the GMDDB reserve using 100% withdraw utilization rate. If an insurance company does not calculate the reserve using 100% utilization rate, the company must disclose its practice in the codification and support its practice with cash flow testing analysis. The analysis should include sensitivity analyses where assumed withdraw utilization rates equal to (a) company experience, (b) 2 times



the company experience, (c) 5 times the company experience, and (e) 100% utilization.

12. Members of LHATF were asked to select the appropriate interim alternatives. Some members selected to do nothing in the interim and wait for the VARWG to pursue the long-term solution. Other members selected to pursue Interim Alternative III Option A and Interim Alternative IV.
13. NY is willing to work with the Academy to develop an explicit formula. CA supports NY's proposed course of action.
14. The Academy intends to do more work on the reserving for GMDB at the September 2003 LHATF meeting in Chicago. It is likely that progress will be made during the fourth quarter of 2003.
15. One regulator indicated that LHATF adopted the Standard Non-Forfeiture Law for Deferred Annuities in a hurry. The regulators are now facing the consequences, and the task force should not walk down the same path again.

Tim Gaynor, FSA, MAAA
Vincent Tsang, FSA, MAAA

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