

Thursday, September 9, 2004: Life & Health Actuarial Task Force

Members present included AK, AR, KS, MN, NE, NM, NY, OR, SC and TX.

Development of a Regulation and Other Topics Pertaining to Nonforfeiture for Individual Deferred Annuities. LHATF began with a discussion of the concept of premium buckets for guaranteed interest rates. It is not mentioned in the current draft of the regulation. Industry wants it as a tool for better management of interest risks. Some states have argued against the concept because of its complexity and because it had not been contemplated in the prior nonforfeiture laws. ACLI countered that it was already being done with crediting rates, hence complexity has already been overcome, and the reason it was never contemplated before was because there was one flat rate applicable for minimum nonforfeiture across the board. Arkansas' argument that LHATF must be flexible seemed to carry the day as LHATF voted 5-4 to include premium buckets. Some members of the industry privately opined that the vote was quite tenuous, since key states such as CA and FL were not present. At least for now, however, premium buckets are back.

The AAA Work Group submitted a 9/9/04 redraft of the regulation. A new Section 4E permits non-disclosure of minimum nonforfeiture parameters unless they are actually utilized in the calculation of guaranteed values. A new Section 6A allows minimum values to decrease in any year as long as the resulting minimum value meets the cumulative requirement – in perhaps an unrealistic example it is theoretically possible to “credit” negative interest to the minimum value. Regulators seemed to have no difficulties with these new sections. LHATF did reject a proposal to raise the “substantive participation in an equity-indexed benefit” to 100 basis points. It will remain at 25 bps.

Mark Peavy (NAIC) and AAA will work on a draft reflecting premium buckets and then schedule a conference call to discuss the result.

Peavy's 7/23/04 draft of AG ABC for projecting guaranteed nonforfeiture benefits under CARVM calculations will be exposed for comments.

Update on C-3 Phase II Work and Variable Annuity Reserves Actuarial Guideline. The AAA Life Capital Adequacy Subcommittee briefly discussed its progress on RBC. They hope to have it passed in December and to be effective for 2005 Annual Statements.

Tom Campbell and Larry Gorski of the AAA Variable Annuity Reserve Work Group outlined many items that still need to be resolved. The list is long, but includes analysis of comments received and their impact, applicability to enforce business, phase-in, need for volatility dampening, etc.



Gorski discussed the implementation of hedging. It must be a well-defined program in order to get reserve credit. It must have been tested and it must be incorporated in the modeling.

Campbell provided a 9/9/04 redraft of AG VACARVM to the regulators but no copies were available for interested parties. It should be available soon on the AAA website. Campbell noted that it reflects the Standard Scenario from July (NY has since modified it, see below), applies to group annuities not subject to CARVM but with benefits similar in nature, does not apply to Modified Guaranteed Annuities, has defined "clearly defined hedging strategy", has a 3-year phase-in, requires the discount rate to reflect expected credit losses, discusses modeling of hedging and has added certification requirements.

Dennis Lauzon (NY) indicated that New York had changed the lapse and revenue assumptions as of August 20. Although too numerous to cite here, see the LHATF August mailing for the details.

Campbell summarized some testing that his group had done comparing modeling with the Standard Scenario. Standard Scenario results are much higher than modeling and seriatim results are even higher than the capital requirements, which are applied in aggregate. Again, there were no copies for interested parties, making it difficult to analyze, but obviously much work needs to be done on the Standard Scenario.

Lauzon referred to a September 3 letter from New York listing open issues. They included the meaning of "prudent best estimate", assumptions used for amortizing surrender charges in the Alternative Methodology, use of forward interest rates, revenue sharing (i.e., mutual fund rebates), non-proportional reinsurance and effects of equity valuation changes (e.g., P/E ratios) on equity return data. Also NY recommends that RBC use 95% CTE and that Alternative Method mortality use 85% of the MGDB table.

LHATF voted to expose the 9/9/04 draft with a 3-year phase-in and updated to reflect the latest Standard Scenario. It will then schedule multiple conference calls to discuss these issues. From the various laundry lists above, there is still a lot of work to be done to resolve all of the issues.

Issues Relative to Actuarial Guideline XXXVIII. As an indication of how hot this topic has once again become, LHATF expanded the allotted 45 minutes to one hour and 45 minutes. Lauzon discussed the revised New York proposal for revising the Guideline. It replaces the multiple steps of #8 with a procedure that fixes net/gross ratios at issue and applies those ratios to the minimum premiums necessary to fund the guarantees, such minimums to be re-determined at every valuation date. Three states (AR, NM, NE) leaned to not making any changes because the trend is to cash flow testing and asset adequacy analysis, lack of resources and the belief that each state already has the ability to deal with abusive situations. TX agreed with NY that changes should be



made to tighten up AG XXXVIII.

Then the fun really started. LHATF solicited comments from interested parties. A group of 10 companies (AmerUS, Jefferson-Pilot, Lincoln National, Midland National, Mutual of Omaha, North American Company for L&H, Pacific, Principal, Protective and Trustmark) for had sent LHATF a joint letter on August 27. In the letter, they stated that no changes were necessary, but that in any case changes should be well thought out and not a hasty response to alarms. Most of the signatories commented to LHATF in person, citing arguments that there is no proof that any company has violated the letter or the spirit of the Guideline, a better long-term solution is model-based, XXX reserves are already too high and it is not possible to cover every situation that might arise. Another company proposed a method similar to AALR for variable life.

Northwestern Mutual, Guardian and New York Life supported changing the Guideline along the lines of New York's proposal, appealing for uniform enforcement and professionalism and arguing that cash flow testing has defects such as subjectivity of assumptions (e.g., lapses) and lack of seriatim applicability.

John Hartnedy (AR) stated that the implications of lack of professionalism were inappropriate and observed that the 3 supporters of changing the Guideline were all mutual companies licensed in New York, such companies always wanting to put capital into additional reserves to reduce excess surplus.

AAA Universal Life Work Group is studying long-term solutions. As such, the WG has no comments on the short-term solutions, but they are looking at a stochastic type of solution for the long term. LHATF asked that group to include term insurance, consider reserves and capital in tandem and also consider nonforfeiture issues such as long level premium guarantees with no cash values.

ACLI commented that stochastic reserves are not tax-deductible, but since stochastic capital requirements do not run afoul of tax laws the group should concentrate on capital issues for these products.

LHATF will schedule a conference call to discuss three proposed solutions: (a) modify along the lines of the New York draft, (b) use stochastically based reserves and capital and (c) leave it up to the states to enforce the current laws.

Possible Areas of Revision to the Standard Valuation Law /International Valuation Topics and General Nonforfeiture. David Sandberg reported on the AAA Nonforfeiture Improvement Work Group's ongoing activity. They are taking an "enterprise risk management" approach that links nonforfeiture, valuation, RBC, non-guaranteed elements (NGE), etc. The main focus of the discussion was NGE. Lauzon cited New York's requirements for NGE: (a) each product must be self-supporting, (b) NGE must



be based on reality (e.g., changes to mortality charges must be based on actual changes in experienced and expected mortality, not on anything else such as expenses or interest), (c) changes to NGE must be authorized by the company's board, and (d) profit goals can not be changed on existing business. Most of these requirements conflict in some way with the direction of the AAA WG.

Interest in this project from interested parties ranges from apathy to opposition. This item will continue to be discussed in December.

IAIS (International Association of Insurance Supervisors - NAIC's international equivalent) asked for feedback on fair value and solvency assessment. Peavy and Lauzon will coordinate a proposed response for discussion on a conference call in November, considering applicability of principles consistently across product lines, objective floors for modeling, taxes as an element of expense and risk, efficacy of regulatory capital levels and solvency time horizons.

GRET Project. The Society of Actuaries continues to study its methodology because of the wide variations it sees from year to year. As a consequence LHATF will not adopt revised factors for 2005 but it hopes to have something for 2006.

Recommendations on Deletions or Amendments to Various NAIC Models. LHATF will send a letter to the (A) Committee that recommends the VA and MGA model regulations be amended to achieve consistency with other regulations such as the recently revised nonforfeiture law for deferred annuities. It also recommends that the IIA (Interest-Indexed Annuity) model regulation be unchanged until formulaic reserve standards replace it.

LHATF will schedule a conference call to discuss consistency with the Interstate Compact National Standards (ICNS) Working Group.

Discussion of the Number and Prioritization of LHATF Projects and 2005 Charges. LHATF adopted 16 charges for next year, all of which relate to existing projects, including life and A&H insurance. The two highest priority projects are the deferred annuity nonforfeiture regulation and the variable annuity reserve regulation.

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12 September 2004

