

Thursday, June 10, 2004: Life & Health Actuarial Task Force

Members present included AR, CA, FL, IL, KS, MN, NE, NM, NY, ND, OH, SC, TX and UT.

Development of a Regulation and Other Topics Pertaining to Nonforfeiture for Individual Deferred Annuities. AAA Committee recommended some changes to the nonforfeiture model regulation.

1. The definition of “basis” used in redetermination now includes the concept of “range”, which is used to determine if the minimum nonforfeiture interest rate changes. The range itself applies to changes in CMT. LHATF spent a fair amount of time discussing symmetry of the range and the maximum range. They concluded that symmetry must be specified in the regulation; i.e., the minimum triggering change must be the same upward and downward. They also set the maximum range at plus or minus 50 basis points to minimize administrative changes.
2. The definition of the equity indexed benefit removes the option for non-equity EI benefits. This means that the additional reduction in minimum nonforfeiture interest rates for EIAs is available only when the underlying asset class is equity-based; e.g., use of a bond index would not qualify.
3. “Index term” is now defined. It is the period of time until the next crediting date.
4. AAA eliminated the market value approach for equity indexed benefits, which was a vestige of an earlier version before certification was introduced.

LHATF members expressed reservations about companies not being required to disclose either the initial method or the initial rate in the contract form. These issues will be discussed in a conference call.

The ACLI promoted a version of the regulation that includes premium buckets. Regulators responded that buckets are not prohibited by the current draft as long as companies can demonstrate compliance and that most designs would probably be able to qualify. Buckets will not be explicitly mentioned in the redraft.

Finally, LHATF staff drafted a guideline to determine the interest rates used in CARVM projections of guaranteed nonforfeiture benefits. LHATF deferred discussion to a future conference call.

LHATF will schedule at least two conference calls to discuss this project before September.

Update on C-3 Phase II Work and Variable Annuity Reserves Actuarial Guideline. The AAA RBC Capital Adequacy Task Force exposed its proposal at the March NAIC meeting with the intent of having it effective for December 31, 2004. That will not happen. Unresolved issues with the level of mortality and with defining the “standard scenario” will push it back to 2005. The Society of Actuaries will assist by doing a mortality study on variable annuities.

AAA Variable Annuity Reserve Working Group (VARWG) submitted a redraft of the reserve guideline, including the standard scenario from the last meeting, a December 31, 2005 effective date and applicability to in force business (issue dates after 1980). They indicated that there were still unresolved issues:

1. The appropriateness of the Alternative Method (an option in lieu of modeling only if there are no guaranteed living benefits in the contract).
2. Whether a phase-in is needed, and if so, how it would be structured.
3. Whether a method to dampen volatility is needed, and if so, how it would be structured.
4. Implementation details.

LHATF and VARWG proceeded to discuss a number of key issues:

1. Factors for the Alternative Method (AM) are on the AAA website. VARWG’s preliminary testing indicates that reserves produced by AM will generally be higher than those produced by modeling.
2. Dennis Lauzon (NY) submitted a laundry list of changes to the Standard Scenario. There was no discussion and VARWG agreed to update the draft to reflect those changes, although a LHATF subgroup (NY, CA and TX) will schedule two conference calls to discuss them. Thus the Standard Scenario is far from final.
3. Timing (use of prior period results – e.g., using September modeling for December reporting) will be dropped from the guideline and addressed in an Academy Practice Note.
4. AAA will continue its work on modeling of hedges, certification issues and Practice Notes for both RBC and reserves. Additional analyses will address the Standard Scenario and the overall impact on representative products.

A redraft of this guideline will be exposed, although a lot of work remains before this project can be completed. LHATF deferred discussion of comments already received for a future conference call. Anyone who desires to comment on the guideline should do so as soon as possible, so it can be discussed on that call..

General Nonforfeiture Project. AAA Nonforfeiture Improvement Work Group presented an informal proposal. It hopes to have a formal recommendation in July that could then be discussed on a conference call. The informal proposal applies to life insurance and annuities, includes non-guaranteed elements

(NGEs), introduces the concept of a “plan” for NGEs filed with regulators and has more certifications by company actuaries.

ACLI Actuarial Committee representatives and ACLI staff vehemently opposed the proposal because of the uncertainty of tax effects, the de facto guaranteeing of NGEs and illustration issues. The ACLI will actively oppose it in the states. Bob Wilcox, AAA President, argued forcefully for the need for this project.

As a side note, this project in some form or another has been debated for 18 years, according to NAIC staff.

Possible Areas of Revision to the Standard Valuation Law. This is another project with a long life. The AAA is looking at this from an “enterprise risk management” approach – i.e., determine all the risks, then prioritize them and come up with a method to deal with them. AAA will have a report submitted for discussion by the September meeting.

Sheldon Summers (CA) again voiced his proposal for a “valuation manual.” There was a lot of discussion but no concrete direction established.

Issues Relative to Actuarial Guideline XXXVIII. Some companies had raised the issue of potential product design schemes that minimize reserves required by AG XXXVIII (AXXX). LHATF has asked for concrete evidence of abuses. Frank Dino (FL) opened the discussion by asking why these incidents were not reported to ABCD. No company had answers.

Summers observed that the calculations in AXXX are quite specific, which hurts the case for cracking down. He recommended that the guideline be revised. Dino countered that changing it in effect admits that it was not clear in the first place and he questioned how there could be an abuse if a company follows the calculations as specified.

There were some comments about catching such abuses in the filing process, but that possibility was dismissed as ineffective.

Hartford Life had volunteered in a prior conference call to design a survey for states to poll their domestic insurers on this issue. They came up with a short but comprehensive survey, but by this point LHATF had soured on the question of directly pursuing such abuses. Instead, LHATF will plan a conference call to discuss helping states beef up their enforcement procedures.

Recommendations on Deletions or Amendments to Various NAIC Models. LHATF has sent a letter to the (A) Committee indicating that LHATF will modify the Variable Annuity Model Regulation and the Modified Guaranteed Annuity Model Regulation and will study the possibility of amending the Interest Indexed Annuity Model Regulation. It does not sound as if the changes will be

substantive. LHATF will discuss how to proceed with this project in a conference call.

Update on Status of GRET Project. GRET, or Generally Recognized Expense Tables, are permitted but not required for use with the Illustration Regulation. An SOA Committee has proposed new factors for 2005. The changes from prior factors are noted below:

Home Service: 3%-5% decreases,
Branch Office: 15%-17% increases,
Other: 3%-7% decreases,
Direct Marketing: 75%-79% increases.

Because of the small number of companies in the last category above, the SOA recommends eliminating Direct Marketing and folding it into Other. LHATF will schedule a conference call to discuss the results.

Review Procedures for Disseminating LHATF Documents and Announcements. Regulators want to establish a forum on which they can exchange questions and ideas. Non-regulators would not be permitted on the forum. Discussion will continue in September.

Discussion of the Number and Prioritization of LHATF Projects. This project will be discussed at the next meeting.

Other Matters. The September NAIC meeting will be in Anchorage, Alaska. LHATF surveyed its members to see if there would be a quorum. Six members will definitely attend, most are still undecided, and only a few will definitely not attend. Ten members are needed for a quorum, so right now it looks promising.

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