

LHATF Conference Call regarding the Standard Scenarios for the Proposed Actuarial Guideline on CARVM and Risk Based Capital Requirement for Variable Annuities

On April 12, 2004, LHATF held a two hour conference call regarding the standard scenarios for the proposed Actuarial Guideline VACARVM, CARVM for Variable Annuities Redefined, and the proposed risk based capital (RBC) for variable annuities. Insurance regulators from various states participated in the conference call. Other participants were insurance companies, ACLI, actuarial consulting firms, accounting firms and other interested parties.

Ms. Leslie Jones of South Carolina Department of Insurance and Mr. Dennis Lauzon of New York State Insurance Department (NYSID) were the leaders of the conference call. Before the conference call, regulators and all other interested parties were provided with the following documents:

1. A draft copy of Actuarial Guideline VACARVM (AGVACR.DOC) as of 12/5/2003.
2. A draft memorandum "Standard Scenarios for Variable Products with Guarantees" (LAUZ03051.DOC) prepared by NYSID.
3. A summary of comments received by NYSID regarding the proposed standard scenarios (LAUZ0406.DOC).
4. A memorandum "IAIS Solvency Subcommittee" (IAIS03091.DOC) prepared by Mr. Alfred W. Gross and Mr. Rob Essen of NAIC.

The primary objective of the conference call was to discuss the technical issues, assumptions, and wording of the proposed standard scenarios for statutory reserves and RBC of variable annuities as well as comments received from the insurance industry.

After all participants and interested parties identified themselves, Ms. Leslie Jones initiated the discussion.

1. Mr. Dennis Lauzon began with a brief description of the proposed standard scenarios. There are two standard scenarios: one for reserves and one for RBC. The valuation method and assumptions for these two standard scenarios are comparable but are not the same. For example, the assumed asset return rates in standard scenarios for reserves and RBC are marginally different. In addition, reserves are calculated on a pre-tax basis and RBC is calculated on an after-tax basis. Readers are encouraged to review and compare these two scenarios' valuation methods and assumptions.



2. California, New York, Texas, and Washington D.C. formed a joint subgroup of Capital Adequacy Task Force (CATF). According to the subgroup, the rationale for the proposed standard scenarios includes, but is not limited to, the following:
 - The proposed VACARVM is a new valuation method. The industry has no prior experience in performing the proposed valuations. Valuation results of the standard scenario can then be used as a minimum floor.
 - The standard scenario may assure that the reserve and the RBC requirements are not unreasonably low.
 - Results of the standard scenarios can be used to compare with results of modeling or Alternative Methodology for validation purpose.
 - Assumptions defined in standard scenarios provide reasonable constraints to the Appointed Actuary's flexibility in choosing actuarial assumptions.
 - As assumptions defined in the standard scenarios are applicable to all insurance companies, the combination of the proposed valuation method and the standard scenarios provide a parallel between the proposed method and the current method, formulaic reserve accompanied by an actuarial opinion.
 - If an insurance company uses the third quarter in force to estimate the year-end reserve, the standard scenario may help both the company and the regulators to review the reasonableness of this approach.
 - The use of standard scenarios facilitates similarities between prior and proposed practices (for example, contract-by-contract calculation, specified actuarial and interest assumptions, identical results for companies selling the same contract).
2. Besides being a floor requirement, results of a standard scenario can be used as tools for (a) comparing results of modeled cells to results of seriatim valuation, (b) comparing results over time, (c) allocating aggregated results to individual contracts, and (d) projecting results for subsequent year-end.
3. An important distinction between the standard scenarios and the stochastic approach is that results of the standard scenarios are further adjusted by the value of hedges. (See "LAUZ03051.DOC" for more details.)
4. The document "IAIS03091.DOC" is a brief summary of a recent meeting among insurance regulators from various countries. Mr. Lauzon indicated that insurance regulators in the international community (US and Europe) share the same concerns regarding insurance company solvency and RBC.
5. Mr. Lauzon also explained briefly actuarial and equity return assumptions stated in the standard scenarios.



6. NY received comments from the industry in three areas: basic concept, specific assumptions, and wording of the drafted standard scenarios.
7. Comments on the basic concept include (a) tax issues, (b) whether the results of the standard scenario always dominate results from stochastic analysis, and (c) lack of resources for small companies to perform the required analysis.
8. Comments on assumptions include (a) whether the discount rate for RBC should be 65% of the discount rate for reserves, (b) allow an investment margin for assets backing fixed account, (c) increase the policyholder benefit election rates over time, (d) whether the minimum reserve of ½% of statement reserve is too strong, (e) whether the assumptions of scenarios should be strengthened or weakened.
9. Comments on wording include (a) allow additional flexibility in performing analysis under the standard scenarios and comparing results under seriatim analysis and model office analysis, (b) provide more guidance on guaranteed withdraw benefits, and (c) clarify the hedging guidance.
10. For more information on the comments and commensurate written responses, please review the document "LAUZ0406.DOC".
11. Tom Campbell of Hartford Life indicated that the Academy's Variable Annuity Reserve Working Group (VARWG) is reviewing the proposed standard scenarios on the following issues:
 - To compare the results of standard scenarios and stochastic model office analysis
 - To determine whether results of standard scenarios are too conservative.
 - To incorporate the proposed standard scenario into the proposed actuarial guideline VACARVM.
 - To evaluate the effects of the standard scenario on tax reserves and the allocation of aggregate reserve to individual contracts.
12. CA asked whether any empirical studies were done in comparing reserves under standard scenarios and stochastic scenarios. VARWG is working on the analysis.
13. Currently, the tentative mortality rates stated in the Alternative Methodology are 65% of GMDB mortality rates. The assumed mortality rates for standard scenarios are 100% of GMDB mortality rates. A mortality study may be required to evaluate whether 65% GMDB mortality rates are too liberal or 100% of GMDB mortality rates are too conservative. Due to the tight timeframe for RBC, there



may not be even time to perform such mortality study. Individual companies may not have enough data for a credible mortality study.

14. The ACLI is studying the standard scenarios from a tax perspective and should shortly provide feedback to regulators regarding tax issues so that the standard scenarios become more "tax friendly."
15. NY indicated that Regulation 128 is currently effective for variable annuities. Companies should keep Regulation 128 in mind.
16. John Hancock Life questioned whether it is redundant to perform both the standard scenario and the Alternative Methodology for RBC. Mr. Lauzon indicated that it is preferable to have companies doing both so that regulators can review the results.
17. CT reiterated its objection of using the yield rate of 10-year constant maturity Treasuries as the Dynamic Rate for discounting because there is little, if any, correlation between equity return and interest rate. CT prefers to use a constant rate. Currently, the proposed discount rate for reserves is the Dynamic Rate plus 50 basis points. The cap and the floor for the dynamic rate are 9% and 3%, respectively.
18. With respect to incorporating a pre-determined investment margin on the assumed investment return of assets supporting the fixed investment option, it may be difficult to do so because different products may have different guaranteed interest rates. NY indicated that the Academy should perform research to justify incorporating an additional investment margin before regulators should consider this proposal. An interested party indicated that there should be consistency between expense charges for separate account business with investment spread for fixed investment business.
19. VARWG is ready to incorporate the standard scenario in the proposed AG VACARVM.
20. There is a special VARWG teaching session on Friday, 4/16/2004 from 9:00-11:00 a.m. (CST) for the proposed variable annuity valuation method.

Vincent Tsang, FSA, MAAA

13 April 2004

