

LHATF Conference Call on May 13, 2004 regarding the Proposed Actuarial Guideline on CARVM for Variable Annuities

On May 13, 2004, LHATF held a 2-hour conference call regarding the proposed Actuarial Guideline VACARVM, CARVM 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 interested parties.

Ms. Leslie Jones of South Carolina Department of Insurance was the leader of the conference call. Before the call, regulators and interested parties were provided with the following documents:

1. A draft copy of Actuarial Guideline VACARVM (AGVACR.DOC) as of 12/5/2003.
2. The April 12, 2004 LHATF conference call meeting minutes.
3. Comments submitted by Mr. William Kling of AEGON regarding the standard scenario.
4. A listing of issues recognized in the December 2003 Meeting.

The primary objective of the conference call was to discuss the following issues that were recognized in the December 2003 Meeting.

I. The regulatory form of the recommended reserve method.

Possible regulatory forms of the proposed reserve method are (a) an actuarial guideline (AG), (b) an insurance regulation or (c) a change to the Standard Valuation Law (SVL). According to the December 2003 meeting, the presumed regulatory form of the proposed reserve method is an actuarial guideline.

Regulators debated on the pros and cons of the options. There are many advantages for adopting the current method as an AG. However, the proposed method may be considered as a departure from CARVM. Accordingly, regulators may need authority to adopt the proposed method as an interpretation of CARVM. South Carolina, New Mexico, and New York are in favor of adopting the proposed reserve method as an AG.

Connecticut, Alaska, and Utah have reservations on the AG approach for the following reasons. First, the proposed method utilizes practices (for example, conditional tail expectation and stochastic simulation) that are new in statutory reserving. Second, the proposed method appears to be creating a new insurance regulation rather than interpreting CARVM. Third, if the proposed method is adopted as an AG, insurance companies may challenge the proposed reserve method as a reasonable interpretation of CARVM. Fourth, adopting the new method as an AG via



the Codification process may not be fruitful if it is in conflict with applicable state law (SVL).

Regardless of the final approach, an AG is needed to explain the details of the proposed reserve method. Insurance regulation should only provide a high level guidance.

After a long debate among regulators, the general consensus was to proceed adopting the proposed reserve method as an AG while simultaneously making necessary changes to the state insurance law so that the proposed reserve method becomes enforceable.

2. Should the proposed reserve method be applicable to all or a portion of in-force policies? If so, should the application be mandatory or elective?

Regulators agreed that the proposed reserve method should apply to all in-force policies (that is, policies issued on or after 1/1/1981) under its scope and that the application should be mandatory.

3. Is the 65 CTE level in the proposed reserve method appropriate?

65 CTE is the average of the worst 35% of the results. Depending on the distribution of the results, the equivalence of 65 CTE ranges from 82nd percentile to over 90th percentile.

Regulators did not object to the use of 65 CTE.

4. Is the Alternative Methodology appropriate?

The Variable Annuity Reserve Working Group (VARWG) of the American Academy of Actuaries (Academy) has developed a tentative set of factors for calculating reserves under the Alternative Methodology. The factors are currently under review. There is a good chance that the final set of reserve factors is available in the June 2004 Meeting. Details for the factors will be included in a revised actuarial guideline VACARVM for the June 2004 Meeting.

Regulators decided not to determine the appropriateness of the Alternative Methodology until the reserve factors are finalized. RBC Phase II project, however, will proceed with the Alternative Methodology.

5. Do we need a minimum reserve floor other than the present value of annuitization benefits?



This issue is related to the standard scenario and the Academy is still working on it. Analysis on having the present value of annuitization benefits as the minimum reserve floor should be available in the June 2004 Meeting. No decision was made on this issue.

6. What is an acceptable method to approximate the reserve using results from a prior period?

Regulators prefer to have the acceptable methods outlined in an Academy practice note rather than in an actuarial guideline or insurance regulation.

7. What is an acceptable method to allocate the resulting aggregate reserve to individual contract? Development of this method depends, in part, on the resolution to Issue #5 above.

The Academy is still working on this issue. If the standard scenario is adopted as a part of the actuarial guideline and serves as the reserve floor, results of the standard scenario will be very helpful for companies to allocate the aggregate reserve to individual contracts on a pro-rata basis. Thus, the development of an acceptable allocation method should be discussed in conjunction with the development of the standard scenario. No decision was made.

8. What is the effective date of the new reserve requirement?

VARWG has been working on the presumption that the effective date of the new reserve requirement is December 31, 2005. As preparing for the new requirement is a significant undertaking, a reasonable effective date is December 31, 2005.

Regulators generally agreed that the effective date should be December 31, 2005. The actuarial guideline should be clear on whether early adoption is appropriate.

9. Is there a need for a phase-in period of the new reserve requirement? If yes, how should it be structured?

Currently, AG VACARVM uses language in AG 33 and 34 for the phase-in period. The phase-in period is not an automatic provision. Companies must request permission from the state of domicile.

Regulators decided to defer the discussion of the phase-in period until a decision is made on the RBC Phase II project regarding phase-in period.



Due to the time limit, the conference call came to an end. Regulators did not have time to discuss the comments submitted by AEGON regarding the standard scenario.

As the Academy is still working on (a) a method to dampen the volatility of results and (b) the treatment of federal income tax on reserves, regulators will discuss these two issues during the June 2004 and September 2004 Meetings.

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