

Thursday, June 9, 2005: Life & Health Actuarial Task Force

15 states and over 100 interested parties attended the first day of the meeting.

Development of a Regulation Pertaining to Nonforfeiture for Individual Deferred Annuities.

Katie Campbell (AK) reviewed her recommendations based upon her research on the Model Law:

1. Multiple nonforfeiture interest rates on a contract are permissible.
2. Transfers between fixed and equity-based accounts should be handled with a proportional method.
3. The treatment of withdrawals should allow either a proportional method or a dollar-for-dollar offset.

Then, in a breathtaking motion, she proposed to change the Model Law by removing indexing, allowing only one nonforfeiture interest rate, and scrapping all work on the Model Regulation. Some regulators believed that to be impractical because the new Law takes effect on January 1, 2006; to change now leaves companies in the lurch. The motion barely failed.

Sheldon Summers (CA) proposed three options to consider for determining the minimum interest rates for policies with any element of EIA. Each rate would be determined on a seriatim basis at the beginning of each contract year and it would apply to the entire contract. These options are:

1. Determine the rate reduction for each fund as if it were a stand-alone fund, and then take a weighted average.
2. Similar to #1, but limit the reduction on each fund to 100 basis points.
3. Assume that the total contract value is in the fund with the least reduction.

LHATF will schedule a conference call to discuss these options.

Finally, An Academy Work Group investigating the Section 6 prospective test recommended that the test be eliminated because it does not accomplish its original objectives of solvency, equity and smoothness of values.

Update on C-3 Phase II Work and Variable Annuity Reserves Actuarial Guideline. The Academy WG proposed a handful of changes to VACARVM, all of which are in the nature of clarifying changes that should not affect results. However, Mike Cebula (NY) proposed some significant changes, including:

1. Using CTE(80) instead of CTE(65).
2. Calculating CTE separately for contracts with VAGLBs and those without



- VAGLBs, and then sum the results. Note that the RBC calculation would not be calculated in two parts.
3. Recognizing revenue sharing only if it is contractually guaranteed to the insurer and any successor.
 4. Calculating the Standard Scenario (SS) Amount on a seriatim basis as the greatest of the following:
 - a. Basic Reserve,
 - b. Basic Adjusted Reserve plus the accumulated charges (imputed if necessary) for VAGLB and GMDB,
 - c. Basic Adjusted Reserve plus the option value of the VAGLB benefits guaranteed in the contract plus the accumulated charges for GMDB,
 - d. SS Reserve.

Interested parties countered that NY's proposal ignores the value of hedging. Also, it is likely that CTE(80) will be greater than CTE(90) in RBC because the latter is tax-adjusted and, once again, it ignores the benefits of aggregation.

A few regulators were leery of modeling involving sub-optimal policyholder behavior. Cebula remarked that NY had informally asked some investment professionals to price the options. Their results were in the neighborhood of 500 basis points, which is actually much higher than the Standard Scenario reserve. Interested parties cited an article in the North American Actuarial Journal that indicated that policyholder behavior, even if sub-optimal, is an integral part of financial economics.

The Academy Work Group noted that it has done some tests splitting buyers into "income" and "investment" types, the difference being the amount and timing of withdrawals. It has some impact on the modeled results, but it does not affect the magnitude of the Standard Scenario reserve.

Mike Boerner (TX) reported that the Standard Scenario subgroup plans to make recommendations at the next meeting. He has also designed a peer review survey.

LHATF will schedule a conference call to discuss the Academy proposal, the New York proposal and peer review.

Mike Batte (NM), Chair of LHATF, remarked that this guideline most likely will not be finished in time to be effective for 2005.

Report From AAA SVL 2 Work Group. The WG gave a brief general overview of its latest report, covering philosophy of regulation, qualifications of reviewers, standards applicable to reviewers, required frequency of review, content and distribution of the review and regulatory structure. The highlight of this session was a presentation by Allan Brender of the Office of the Superintendent of Financial Institutions (Canada). He made a number of



cogent observations of the Canadian peer review process.

In Canada, the regulators approve company models, interest-generators and related items. Company actuaries have been responsible for choosing assumptions since 1978. OSFI does not set the standards, but it works closely with the CIA, which does set standards. Peer review is performed by an outside consultant, who may be part of the auditing firm. However, peer review must be a separate engagement from the audit itself. The report goes to the company, its audit committee and the regulator. Assumptions are confidential. The report can be pre- or post-release of the appointed actuary's opinion, with the former encouraged.

LHATF members appeared quite interested in the Canadian process, although Brender noted that Canada is merely the size of California and that OSFI knows most of the high level actuaries in the country fairly well, factors that make the Canadian process easier to implement and maintain. Discussion of this project will continue at the next meeting.

Report From AAA Nonforfeiture Improvement Work Group. This group has received little feedback since the last meeting. It intends to deliver a report in September. The group noted that it is working closely with an Academy Tax Work Group.

SOA Efforts to Collect Mortality Data. Tom Rhodes (MIB) reported on SOA efforts to perform future mortality studies. SOA has recruited 20 companies for the 2000-2001 study, up from 10 in the prior study. SOA seeks companies writing preferred risk term and UL so that it can produce studies by underwriting class. SOA will accept data in any reasonable form, a major change from prior studies.

Rhodes is asking LHATF to issue a resolution supporting SOA's efforts to get risk class as part of the current data call. He is optimistic that the SOA can get 50 companies to contribute soon. LHATF will discuss possible actions on a conference call.

Valuation Mortality – Interim Solution. Mike Boerner (TX) would like interim valuation mortality tables developed by 2007 that reflect preferred and standard classes. This would help companies that are facing overly conservative reserves on XXX and high costs of letters of credit and securitization. LHATF requested that the Academy develop such tables and the criteria for using them, although AAA indicated that its principles-based approach to reserves will remain its top priority.

GRET Factors for 2006. LHATF will expose for comments the GRET factors recently received from the SOA for use with the Life Insurance Illustration Regulation. The proposed factors are significantly higher than the current ones.

Deletions or Amendments to Various NAIC Models. There was no time to discuss this issue. LHATF instead will schedule a conference call.



Actuarial Guideline ABC. There was also no time to discuss this issue. LHATF instead will schedule a conference call.

Friday, June 10, 2005: Accident & Health Working Group

Did not attend, but see the second item below from Friday afternoon.

Friday, June 10, 2005: Life & Health Actuarial Task Force

The same 15 states and over 100 interested parties attended this session also.

Approve Minutes. LHATF approved the minutes of the last meeting and of all conference calls since then.

Report of the A&H Working Group. The WG reported that it had continued work on the following items from its morning meeting:

1. Minimum standards on LTC reserves.
2. AAA recommendation on changes to the LTC Experience page in the Annual Statement blank.
3. Statutory Accounting Principles Work Group request on individual and group health minimum reserve standards.
4. Closed block rating issues on individual medical insurance.
5. Premium deficiency reserves.

The Working Group will schedule conference calls to discuss items #3 and #4.

AAA Universal Life Work Group Update. Members of this Work Group have been quite active, meeting face-to-face with a number of insurance departments, with more meetings upcoming. The Work Group has established the following principles:

1. The method must capture the degree of risk in a product.
2. The method can be applied to all life insurance products.
3. A deterministic approach may be appropriate for certain products, while a stochastic approach may be necessary for others.
4. Assumptions will be a blend of prescribed assumptions and company experience, with the blend determined by the degree of control a company has over the risk in question.
5. For risks that are not stochastically modeled, assumptions should be based upon prudent best estimates – i.e., at the conservative end of the actuary's confidence interval.
6. An acceptable review and governance process must be established.



7. Appropriate controls, limits and caps are necessary constraints on actuarial judgment.
8. Assumptions are not locked in at issue.
9. Because stochastic models do not perfectly reflect reality, the actual reserves arise from the risks to which the company is exposed in reality.
10. The use of assumptions and risk management strategies should be appropriate to the business and not merely constructed to exploit foreknowledge of the components of the required methodology.

In the individual meetings with insurance departments, the Work Group elicited a lengthy list of regulators' concerns. Although too long to list here, some highlights include grading in the approach from current requirements, no mortality improvement beyond the valuation date, setting caps and limits, modeling of hedges, seriatim cash value floors, volatility due to unlocking and alternative approaches for small companies.

LHATF will schedule a conference call to discuss principles only. LHATF asked for comments from both regulators and interested parties within the next thirty days.

The Work Group also presented an example of how a company might approach the development of a mortality assumption. Although it was quite detailed for the time allotted, it provided an excellent guide, especially for companies with multiple risk classes.

Issues Relative to Actuarial Guideline XXXVIII. There was some industry support, with reservations, for the May 9 draft of AG 38, also known as the "7% solution". Some companies would like the July 1, 2005 effective date pushed back. Others are concerned that a drafting note seems to lessen the urgency for a principles-based solution. One regulator expressed concerns with having a sunset date (currently March 31, 2007), and also mentioned that he is aware of a product design with two sets of mortality charges, one of which is used if the secondary guarantee is "in-the-money" and the other of which is used if the secondary guarantee is "out-of-the-money". ACLI indicated that its Board has not yet met to determine a position and thus ACLI must be neutral at this time.

After a relatively short discussion of all these issues, LHATF overwhelmingly approved the May 9 draft with no changes.

Postscript: The (A) Committee, LHATF's parent committee for life insurance issues, at its meeting on Sunday June 12, deferred adoption of AG XXXVIII. The (A) Committee will hold a public hearing to inform Commissioners about the long-term solution and to discuss AG XXXVIII. Commissioner Poolman (ND), Chair of the (A) Committee, also asked the Academy to discuss governance issues at the hearing.

Donald P. Maves, FSA, MAAA

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