

Thursday, December 1, 2005: Life & Health Actuarial Task Force

Actuarial Guideline VA CARVM. This was an action-packed, fun-filled session – a “shootout at the VA corral” if you will. LHATF heard presentations from the AAA VA Reserve Work Group (VARWG), New York and ACLI.

VARWG presented its December report, in which it commented on LHATF proposals that affect the Conditional Tail Amount (CTE) and Standard Scenario issues. First, the CTE comments:

1. Increase CTE level from CTE(65) to CTE(80):
 - a. CTE(65) approximates the 85.5th percentile and CTE(80) the 92nd percentile, given a normal distribution.
 - b. CTE(80) is likely to exceed RBC’s requirement of CTE(90), because reserves are pre-tax and RBC is after-tax.
 - c. CTE(65) applied to a distribution of greatest present value of accumulated deficiencies (as VA CARVM does) is stronger than CTE(65) applied to a distribution of present value of cash flows.
 - d. How does the level of reserves required under VA CARVM compare to reserves for other products?
2. Calculate CTE separately for contracts with VAGLB’s and those without VAGLB’s.
 - a. VARWG opposes this action because it is fundamentally different than its recommended principles-based approach.
 - b. This action could result in mismatches for companies that hedge.
 - c. If LHATF has concerns about the offset of risks, it could require this proposal for informational purposes only.
3. Limit revenue sharing to income that is contractually guaranteed.
 - a. VARWG opposes this action.
 - b. This action can result in a mismatch of expenses and associated revenue.
4. Prescribe assumptions when there is a lack of credible data.
 - a. It is already addressed in VA CARVM.
 - b. It would increase the time and effort to comply.
 - c. It moves further away from principles-based reserves.
5. Eliminate calibration points and use prescribed scenarios.
 - a. VARWG opposes this action.
 - b. The use of prescribed scenarios hinders the development of actuarial practice related to the development of stochastic scenarios.
 - c. It is a huge task to develop and maintain prescribed scenarios.

Then VARWG commented on the Standard Scenario (SS) as described in LHATF’s April proposal:

1. SS is not part of VARWG’s recommendation.



2. Observations about the current SS procedure.
 - a. No justification has ever been presented to determine if the SS is a reasonable floor.
 - b. SS requires a significant number of calculations in addition to the CTE determination.
 - c. A single scenario is inadequate to capture the nature of all risks.
 - d. SS does not encourage effective hedging.
 - e. It is not a simple calculation.
3. Analysis of results produced by SS.
 - a. SS could result in reserves that exceed CTE(65) under many plausible circumstances.
 - b. The lack of aggregation in SS is the major factor in its high reserves.
4. The SS as designed does not meet the goal of producing reserves lower than CTE unless the company used aggressive assumptions.
5. The August 19 proposal from New York is even more conservative and requires substantially more work than the April proposal.

VARWG has made many of the comments above repeatedly in the last six months. LHATF did not respond to VARWG, but segued into New York's latest revision.

New York added comments about margins, handling risks not reflected in the model and modeling policyholder behavior. NY dropped its proposal on using prescribed scenarios instead of calibration points in projecting fund returns, so there is something on which NY and VARWG agree.

A few LHATF members questioned the 100% efficiency assumption associated with policyholder behavior. They contended that most policyholders do not perform sophisticated analyses. They also noted that an annuity policy is usually only part of the typical policyholder's financial portfolio, and thus it is difficult to determine the optimal action for the annuity alone.

VARWG had not had a chance to review the NY revision in depth. However, VARWG already had objections because of the added conservatism, use (or non-use) of credible data and other unmentioned inconsistencies. ACLI supported VARWG's preliminary conclusions.

ACLI then described its proposal. ACLI believes that principles-based reserves have direct applicability to VA CARVM. ACLI generally supports LHATF's April draft, with the following exceptions:

1. CTE(80) is too conservative.
2. Calculating reserves for contracts with VAGLB's and for contracts without VAGLB's separately and then adding is not appropriate.



3. Revenue sharing arrangements should be recognized even if non-contractual.

ACLI had a separate set of recommendations for fixing the Standard Scenario:

1. Apply the seriatim cash value floor to the total contract reserve rather than at the Basic Adjusted Reserve level.
2. Eliminate the AFIR calculation.
3. Use a discount rate equal to the valuation interest rate.
4. Eliminate the Basic Reserve calculation because it is redundant.
5. Allow implicit charges for a given guaranteed benefit if there are no explicit charges.
6. Simplify the “in-the moneyness” calculation by comparing the account value to the value of the guaranteed benefit at each model duration.
7. Use a mortality assumption of 70% of the MGDB Table.
8. Revise the lapse and utilization assumptions.
9. Allow the use of Clearly Defined Hedging Strategy in the hedging allowance.

Finally, ACLI recommended not extending AG 39 as well as putting a sunset provision into the Standard Scenario in anticipation that SS will go away once principles-based reserves take effect.

LHATF passed a motion (by a vote of 8 to 4) to modify the April draft of VA CARVM with the ACLI’s recommendations and expose it for comments. NY wanted to expose its own recommendations for comments, but that action died.

LHATF did not have time to discuss AG 39, but indicated that it will take up that item on Friday.

Interim Proposal Relative to New Valuation Standards. An ACLI group presented an interim proposal for a new valuation standard to serve as a bridge between AG 38 and principles-based reserves (PBR). The genesis of this project is the “CEO compromise” on AG 38, the sunset provision in the revised AG 38 and the long-term goal of PBR.

Its significant components comprise utilization of (a) preferred mortality, (b) limited use of lapse rates and (c) the surrender charge offset for non-premium paying UL with secondary guarantees.

For (a) preferred mortality, the ACLI presented non-smoker mortality for super preferred, preferred and residual standard classes. For smokers, the ACLI would split mortality into preferred and standard classes. The presenters emphasized that the 2001 CSO Table served as the basis for the splits of the various classes. The ACLI performed no projection of mortality experience or update of the prevalence of preferred classes beyond that table. The mortality assumption should change after issue if experience emerges differently from expected.



For (b) lapse rates, this proposal limits their use to UL with secondary guarantees - and then only to the AG 38 adjustment, not the basic XXX reserve. Lapses are prescribed, simple and modest.

There was no elaboration of (c) the surrender charge offset.

The ACLI group repeatedly emphasized that its work product represented a compromise among the major combatants of the AG 38 war. Consequently, they recommended that LHATF should consider the proposal in its entirety instead of nitpicking each element.

In order to implement this bridge, the ACLI drafted (1) regulation that recognizes preferred mortality in valuation and (2) a revised AG 38.

The ACLI requested that LHATF expose these items for comments in order to aim for adoption by early 2007. However, the LHATF declined to act and instead scheduled a conference call to discuss the proposal.

Interim Table for Preferred and Standard Mortality Classes. The Joint SOA/AAA POG (project oversight group) gave an update of its work in deriving preferred and non-preferred mortality. This project is not directly related to the immediately preceding project. This group has an interim goal – mortality class splits for use with 2001 CSO – and a long-term focus related to principles-based reserves.

The POG has established a plethora of teams that are actively addressing such issues as data validation, underwriting criteria, analysis of experience, development of a basic table, implementation of the proposal and development of a valuation table. The goal is to have the valuation table completed by April of 2007.

Report from AAA SVL2 Work Group. This Academy group sets the overall direction of the project to develop a principles-based reserve (PBR) and capital system. Included in its myriad work groups are the Variable Annuity Work Group (see above) and the Life Reserve Work Group (see below). The role of SVL2 is to establish, monitor and coordinate the direction of such work groups.

SVL2 is aiming to produce (a) a set of principles applicable to all lines of business (including health), (b) a standardized format for reporting to regulators, (c) definitions of terms that apply across all lines of business and (d) updates via website, webcasts and educational seminars.

With all the various groups and subgroups working on what seem to be related but somewhat different aspects of reserves, can it get any more complicated than this? Yes it can. The ACLI announced that it is working on a draft of a Standard Valuation Law that



would recognize PBR. Their goal is to have a draft by March of next year.

Chairman Mike Batte (NM) wrapped up this topic by asking for comments from LHATF members about the direction of this project. Feedback included a desire for meaningful controls, the difficulty of enforcement, the need to grant limited freedom to appointed actuaries and a recommendation to move aggressively to implement change.

NY moved to appoint a LHATF subgroup to draft a revised Standard Valuation Law, based on a prior NY proposal. It narrowly passed, 8-6. The ACLI and others expressed reservations about NY's approach.

Report of the AAA Life Reserve Work Group. This group, formerly known as the Universal Life Work Group, presented its recommendations for a principles-based reserve (PBR) system. The group drafted a model regulation for implementing PBR and three accompanying actuarial guidelines – AG PBR for setting assumptions, AG DIS for disclosure requirements and AG MAR for margin requirements.

The Work Group highlighted a number of new or revised items from its prior work:

1. The scope includes all life products, hence the group's name change.
2. Companies would map their various risk classes to a series of mortality tables approved by LHATF.
3. Companies may use internal interest rate generators if they meet prescribed calibration points.
4. Companies may use aggregation for stochastically computed reserves.
5. They defined a method to determine the earned rates and the discount rates.
6. Companies may use deterministic methods under certain conditions.
7. They prescribed the treatment of non-guaranteed elements (NGE).
8. There are expanded requirements for documentation and disclosure.
9. The proposal describes the treatment of various miscellaneous items such as Separate Accounts, revenue sharing, allocation of stochastic reserves, aggregate margin quantification and modeling of hedges.

The Work Group also indicated that the following items need additional refinement:

1. Variable life and equity-indexed UL.
2. Methods to determine margins.
3. Calibration standards for interest rate scenarios.
4. Treatment of NGE.
5. Documentation requirements for NGE, reinsurance and revenue sharing.

Some LHATF members expressed concern for the burdens put on small companies. The Work Group responded that if a small company elects to sell risky products it should comply with the requirements. Regulators left the door open for relief for small companies operating



in one state only.

Another LHATF member fretted that companies could manipulate bad scenarios – for example, by saying that they will change crediting strategies if those conditions occur. The Work Group remarked that that is not necessarily bad if it forces companies to examine the conditions leading to bad results and what ameliorative actions they could take.

LHATF voted near unanimously to expose the regulation and guidelines for comments, although that does not mean that it necessarily supports the package. The ACLI and other interested parties expressed support for the direction taken.

Finally, The Work Group reviewed the results of some modeling of a 20-year term plan. While the displayed reserves were lower than current XXX levels, one LHATF member as well as interested parties noted that the resulting reserves were nevertheless substantially higher than an economic reserve.

Friday morning, December 2, 2005: Accident & Health Working Group

Minimum Standards Applicable to Statutory Reserves for Long-Term Care Insurance. New Long Term Care experience forms will replace the current forms. After discussion, the Working Group agreed to expose the new forms with minor adjustments. After the exposure period, the changes will go to the Blanks committee and they will be exposed a second time. The new experience forms do not have state-specific information, so there is a second proposal to add LTC premium, incurred claims, and policy count information to the state page.

Changes to Minimum Reserve Standards for Individual and Group Health Insurance Contracts. A revised Health Insurance Model Regulation and a revised Appendix A-010 of the Accounting Practices and Procedures Manual (the health insurance model regulation) have been exposed. There were limited comments and the Working Group agreed to make one change to clarify language on DI claim reserves.

Premium Deficiency Reserves. Last summer the Working Group proposed dropping the topic of health Premium Deficiency Reserves since they could not reach a consensus. The health insurance trade group AHIP asked that they be permitted to draft a proposal, with the goal of uniform practice among the states. Bill Weller presented AHIP's outline of what Premium Deficiency Reserves should cover and what they shouldn't cover. He also proposed changes to the Health Reserve Guidance Manual (HRGM) to implement their proposal. Julie Phillips, Chairperson, stated that there were a number of changes that were on the list for changing in the HRGM. She asked if there was a regulator who was willing to take on the task of updating the HRGM, or, failing that, to take on the task of updating the HRGM for Premium Deficiency Reserves as proposed by AHIP. At first there were no takers and it looked like the project was going to die, but during a break Joe Musgrove of



Arkansas agreed to head a taskforce that will be limited to Premium Deficiency Reserves.

Presentation on Health Care Trends. There was an educational presentation on healthcare trends.

Report of the SOA Cancer Experience Study Group. The Working Group received an update on work on a new cancer valuation table. Work on gathering company experience data has begun.

Alternatives for Individual Medical Rate Regulation. The American Academy of Actuaries had done work on Individual Medical rate regulation and cost spirals on closed blocks. The NAIC staff had prepared a rough draft of a regulation and AHIP had responded to that with several comments. Julia Phillips will lead the task force to create a regulation.

Friday afternoon, December 2, 2005: Life & Health Actuarial Task Force

Approve Minutes. LHATF approved the minutes of its October 24 and October 31 conference calls.

Report of the A&H Working Group. See the Friday morning session above for a complete discussion of this subgroup's activities.

Various CADTF/LHATF Topics. LHATF proposed extending the expiry date of AG 39 from 1/1/2006 to 1/1/2008. Hartford Life and ACLI opposed, citing the lack of a release mechanism for accumulation of charges, inappropriate recognition of risks associated with VAGLB's and lack of recognition of the costs of hedging. LHATF passed it unanimously anyway.

TX summarized current thoughts on independent peer review. The Commissioner would be the client, although the company would bear the cost of the review. AAA recommended that the Board or the company be the client. Timing of the peer review report is still uncertain, but LHATF members seem to lean toward pre-release (i.e., before financial results are filed). One LHATF member questioned how peer review would accommodate large reserve swings under a principles-based system. This project, being relatively new, has much work remaining to consider all the issues.

Report of the AAA Nonforfeiture Improvement Work Group. AAA is working with various tax experts to avoid creating unfavorable tax treatments of policyholders and companies. It expects to file a formal report at the March meeting of LHATF. Northwestern Mutual urged LHATF and AAA not to ignore the real economic prospective value of insurance (a reference to the activity of viatical settlement companies).



Report on SOA Preneed Mortality Experience Study. Ten preneed companies plan to contribute mortality data to an SOA task force. Preneed insurance is used to fund funeral expenses; it generally has much different levels and patterns of mortality experience than 2001 CSO. The SOA group plans to issue a report of its analysis in March and a recommendation for new valuation tables in June.

Deletions or Amendments to Various NAIC Models. The afternoon session sailed along ahead of schedule until LHATF came to this item. The Modified Guaranteed Annuity revision exposed for comment on the October 24 call was adopted. Then LHATF spent a lot of time debating whether the Variable Annuity regulation should refer to guideline VA CARVM. LHATF finally decided not to make such a reference, primarily because VA CARVM does not yet exist. However, LHATF did change the VA regulation to describe how to handle mortality and expense results that affect the amount of benefits. It will be re-exposed for comments.

Actuarial Guideline ABC. This proposed guideline describes the projection of guaranteed nonforfeiture benefits under CARVM in light of the new annuity nonforfeiture law. As in the prior item, LHATF made up for found time with an extended discussion about determining the future nonforfeiture interest rate when it is not known in advance. After making some small changes, LHATF voted not to adopt the revision in an exciting down-to-the wire roll call vote of 8-7 (it was tied at 7-7 when Chairman Batte voted No to break the deadlock). LHATF then voted to expose the revised guideline for comments.

Other Matters. LHATF expects to schedule a series of conference calls before its March meeting; dates, times and topics still to be determined.

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