

AAA UL Work Group

The Academy's UL Work Group updated LHATF on its progress to date on the development of a principles-based approach to reserves for life insurance.

The WG is somewhat misnamed, as it is studying UL with secondary guarantees, term insurance and VUL, and then expanding the approach to cover all life insurance. The WG plans to address both reserves and capital (i.e., RBC).

Highlights of the preliminary proposed approach include:

1. The reserve will be the greater of a deterministic calculation and a stochastically derived reserve.
2. The stochastic reserve uses a prescribed CTE level.
3. Not all assumptions need to be stochastically modeled; for those that are not modeled, the method requires a Prudent Best Estimate (PBE) approach.
4. For risks over which the company has some control, such as mortality, the method permits assumptions based on credible company experience.
5. For risks over which the company has little control, such as interest movements, the method requires prescribed assumptions.
6. The opening actuary will not have complete discretion to set reserve and RBC levels.
7. There is no lock-in of assumptions at issue or at any time thereafter.

LHATF members had serious reservations with the approach. Dino (FL) remarked that modeling policyholder behavior is quite difficult. When the WG countered that these assumptions would be subject to sensitivity tests, Dino rejoined that if an initial assumption is wildly off at the start, sensitivity testing is of no help. He cited some experience with LTC reserves.

Carmello (NY) does not support the project unless there is an "objective" minimum reserve based on standard parameters. He believes that the pressures on the opening actuary to use favorable assumptions would otherwise be too great to make the reserves appropriate.

Following the LHATF feedback on the general approach, the UL WG discussed progress of five of its subgroups – mortality assumptions, assets, policyholder behavior, expenses and reinsurance. Highlights of each subgroup follow.

Mortality assumptions should be based upon a combination of relevant company experience and industry experience, depending on the degree of credibility associated with the internal experience. The actuary must adjust assumptions to reflect differences in risk classes. He or she should also add margins for adverse deviation.



The asset subgroup recommends modeling actual company assets and reinvestment strategies, using a C3 Phase I generator for Treasury rates and deriving credit spreads and defaults via a PBE approach. NY wants asset spreads limited in some way so that riskier portfolios do not result in lower reserves.

Policyholder behavior assumptions will be based upon a PBE approach with sensitivity testing. The withdrawal assumption must include an explicit margin, subject to caps and floors.

Expenses should be fully allocated (i.e., reflect both direct costs and indirect costs and overhead), should be adjusted over time for inflation and should not reflect future improvement.

The reinsurance subgroup recommends that reserves be calculated net of reinsurance ceded. There would be no requirement that the ceding company and the assuming company use identical assumptions.

The call closed with more feedback from LHATF. Bruning (KS) does not want a situation to develop in which a closed block has significant reserve problems. Dino observed that the proposed approach raises the possibility of large reserve swings. What, he wonders, will companies do when they have to increase reserves significantly.

The UL WG will continue to work on its proposal in light of today's feedback. Discussion of topic will continue at the June meeting of LHATF.

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20 April 2005

