

Thursday, March 2, 2006: Life & Health Actuarial Task Force

Members from 15 states and nearly 100 interested parties attended this session. Mark Peavy, the NAIC staff actuary assigned to this task force for many years, retired last month. Randall Stevenson, who has been working on actuarially-related A&H issues at the NAIC, will take over the LHATF assignment.

Mike Batte (NM) welcomed the attendees by singing the opening theme song from “The Mickey Mouse Club” TV show. While he will never be confused with Pavarotti, it was nevertheless a bravura performance.

Actuarial Guideline VA CARVM. The Academy Work Group (VARWG) presented comments on the January 25, 2006 draft of VA-CARVM:

1. Increasing the CTE level from 65 to 75 adds a significant amount to the modeled reserves, when there are already elements of conservatism in CTE (65),
2. A reserve “deemed adequate to substantially cover the risk associated with the tail” in Principle 2 implies a reserve level that is at or beyond the Total Asset Requirement for RBC,
3. The margin for adverse deviation included as part of a Prudent Best Estimate is confusing because it is unclear how to measure “financial efficiency”,
4. To show modeling results without dynamic hedging for informational purposes ignores that a Clearly Defined Hedging Strategy reflects buying and selling of assets over a long term,
5. The proposal on revenue sharing results in a mismatch of expenses and revenues,
6. The Standard Scenario changes are complex, do not produce the desired floor and go beyond targeting companies that use aggressive assumptions, and
7. The changes to contractholder behavior assumptions are inappropriate.

Bill Carmello (NY) responded:

1. CTE (75) is necessary to cover significant tail losses, such as those resulting from a significant market drop,
2. NY will reconsider Principle 2,
3. Simple margins for adverse deviation are not appropriate in all cases, and should reflect the degree of “in-the-moneyness”,
4. NY agrees with the comment about showing results without dynamic hedging,
5. NY will reconsider the revenue sharing requirements,
6. The Standard Scenario is needed because (a) it is not excessively conservative (the problem might be the assumptions used in modeling), (b) aggregation in modeling masks some of the risks and (c) modeling does not handle ratchet benefits well, and



7. Assumptions about contractholder behavior must be reasonably “efficient”.

The ACLI voiced concern over the complexity and use of time and resources for compliance and the need to consider tax effects. It promised to perform an analysis of the Standard Scenario.

Carmello opined that he could not see how VA-CARVM could be effective for 2006 unless LHATF passes it in June. He then vowed to work with the ACLI to resolve the issues.

LHATF will schedule 2 conference calls to continue the discussion.

So there you have it. We have heard many of these objections from VARWG before and many of the rebuttals from LHATF before. Stay tuned for the exciting conclusion.

Interim Proposal Relative to New Valuation Standards. The ACLI had previously proposed interim standards for AXXX policies until Principles-Based Reserves (PBR) became effective. The proposal recommended the use of preferred and non-preferred mortality developed by a consultant, modest lapses and surrender charge offsets.

Paul Graham (ACLI) discussed whether the Standard Valuation Law permits lapses. The ACLI has received a law firm’s legal opinion that affirms that ability. The ACLI sent it to the (A) Committee, which forwarded it to NAIC legal counsel. The ACLI has also sent it to all state insurance Commissioners.

Graham then attempted to assuage LHATF members’ fears about using an interim mortality table without the imprimatur of the SOA. The most subjective issues in the development of the table are mortality at older ages and the persistency of the preferred effect. The ACLI solved the first issue by using the consultant’s existing older age study. However, tests showed that grading off the effect of preferred underwriting caused a steeply sloped table that provided no reserve relief; hence the ACLI allowed the effect to continue forever.

Graham cited a number of reasons why the proposal is valid:

1. The result is modest reserve reduction,
2. Companies must provide a certification of the appropriateness of the table chosen, much like they do now for X-factors, and
3. Companies have no incentive to lowball the mortality, because if they must raise reserves (mortality is not “locked in” at issue), the increase is not deductible for tax purposes.

LHATF was not amused. When asked directly, no member supported the use of lapses. LHATF members are wary of using a table not reviewed by the SOA, although ACLI observed that by its very nature and purpose this proposal cannot afford significant delays.



Finally, Frank Dino (FL) expressed heightened discomfort after hearing #3 above. He believes that statutory reserving should start conservatively and release margins when experience warrants, not start with low reserves and have to raise them later.

LHATF members did not reject the proposal out of hand, but agreed to schedule a conference call for additional discussion and a conference call to formulate a charge to the SOA to validate the work of the ACLI.

Interim Table for Preferred and Standard Mortality Classes. This project is not related to the project immediately preceding it, but is rather an outgrowth of PBR. The Joint SOA/AAA Project Oversight Task Force updated LHATF on its progress. Data validation is well under way, with 49 companies contributing data. The group expects to have a regulation and a valuation table completed by March, 2007. The table will not reproduce the 2001 CSO Table, which raises tax considerations that this group plans to address.

Report of the SVL2 Subgroup of LHATF. Larry Bruning (KS) went through his presentation from a recent AAA webcast, which was a high-level overview of PBR. The principles-based approach is a framework for identifying all risks, measuring and modeling those risks and documenting the conclusions.

The key elements of modeling are:

1. Choice and calibration of scenarios,
2. Variability,
3. Robustness,
4. Granularity of the asset classes, and
5. Granularity of the liability classes.

He also listed the key elements that companies must evaluate in their models:

1. Company experience and credibility,
2. Investment policy, including hedging,
3. Selection of margins,
4. Sensitivity analyses, and
5. Appropriate and complete documentation.

Report of the AAA SVL2 Work Group. This group, the Risk Management and Financial Soundness Committee, also functions as the SVL2/PBA Steering Committee. (PBA refers to the Principles-Based Approach.) Because this Committee has billions of subcommittees and work groups, AAA has scheduled a March 22 webcast to provide an update on all PBA projects.

This group used much of the time frame to discuss PBA review, which is not the same as



peer review. The focus of the PBA review is on actuarial judgment rather than auditing, on process rather than numerical results. Examples are the derivation of assumptions from experience and the model construction process.

Dino had concerns that the PBA reviewer is limited to the actuary's work and does not include his reliance on other people such as the investment officer, and that the reviewer's opinion does not include anything about the appropriateness of the reserves.

The group favors pre-release reports from reviewers, but it still must grapple with many other issues, such as who hires the PBA reviewer, who can do it, the qualifications for the reviewer, the scope of the review and the report structure. This group will issue a "white paper" on PBA review and governance by June, 2006. In addition, LHATF will schedule two conference calls.

The group then outlined a set of consistency principles for PBA:

1. Capture all material risks, benefits and guarantees,
2. Use risk analysis and risk management techniques to quantify risks,
3. Use assumptions and methods that are consistent with a company's risk assessment process,
4. Use credible company experience for assumptions over which the company has some control, and
5. Provide for prudent best estimate assumptions that reflect appropriate conservatism.

Finally, the group gave a short summary of its Annuity Reserve Work Group, which is considering all non-variable products and is trying to fit a single approach to all such products.

Report of the AAA Life Reserves Work Group. This is one of the subgroups under the SVL2/PBA Steering Committee. It offered some thoughts on why margins can be different (i.e., lower) under PBA as compared to the current process:

1. Assumptions reflect risk characteristics of each company,
2. Assumptions are not "locked in" at issue,
3. Policyholder behavior is reflected directly, and
4. Implicit margins, such as cash value floor and lack of mortality improvement in assumptions, already exist.

It introduced a Z factor for measuring margins. Z equals the reserve held less the best estimate reserve, divided by the present value of capital requirements. It is the excess of the pre-tax return on capital over the return on invested assets. The Z factor could be useful as a disclosure item.



Bill Carmello (NY) summarized his concerns:

1. NY asks companies to consider FIT in asset adequacy analyses,
2. NY provides for a penalty mechanism for overly aggressive assumptions,
3. He would like to see less aggregation in models,
4. He fears that the current proposal allows the determination of discount rates such that a company could reduce reserves by investing in riskier assets,
5. He wants mandated experience reporting, and
6. He wants a seriatim fair value calculation of reserves for informational purposes, using discount rates that reflect the current Treasury yield curve.

Graham (ACLI) remarked that setting deterministic reserves too high discourages modeling because of the effort involved. When queried if small companies have complained, he replied that there has not been much response. However, the ACLI intends to publicize the issue at an upcoming Forum 500 (composed of small company members) meeting.

Friday morning, March 3, 2006: Accident & Health Working Group

Did not attend, but see the summary report of this Working Group on Friday afternoon.

Friday afternoon, March 3, 2006: Life & Health Actuarial Task Force

Approve Minutes. LHATF approved the minutes of its recent conference calls.

Report of the A&H Working Group. The statuses of this group's projects are:

1. It completed its recommendation on modifications to the Long-Term Care Experience Reporting forms,
2. It recommended a large number of minor changes to SSAP 59 (Credit Life and A&H Contracts) and A-010 (Minimum Reserve Standards for Individual and Group Health Insurance Contracts),
3. It continues to study rating for individual major medical closed blocks,
4. It continues to study premium deficiency reserves, and
5. It made some technical corrections to the Health Reserve Guidance Manual.

Report from the CADTF/LHATF Joint Subgroup. This subgroup reported that on recent conference calls it continued to discuss issues related to a corporate governance regulation, an annual audited financial reports regulation and a paper on a risk-focused surveillance framework.



Carmello (NY) summarized those issues as Board involvement, setting limits on product sales, identification of risks, hedging and assessment of risks. He then solicited feedback from LHATF members on governance and audited financial reports.

Report of the AAA Nonforfeiture Improvement Work Group. This group declined to give a report because of an unelaborated “rebellion” in the ranks. However, Bill Koenig, speaking as an employee of Northwestern Mutual and not as a member of the group, criticized the group’s reports for ignoring the true economic value of life insurance - citing a viatical settlement ad as evidence – and for allowing cash settlements to be optional. He then made an impassioned plea to LHATF members either to require cash if any nonforfeiture option is present or to drop the project.

Carmello asked for ACLI feedback on the position of its members. ACLI could not respond because this issue has not arisen there. AAA promised a “white paper” on the issue by June, 2006.

Reinsurance Reserve Credits. This item was not scheduled on the agenda. Nevertheless, Sheldon Summers (CA) asked for time to discuss a problem that he has. He is aware that some companies are taking a ceded reserve credit that exceeds the direct reserve on some policies. One way that this can occur is if the premium mode is monthly for the policyowner, but annual for the reinsurance premium. He proposed prohibiting the total ceded reserve credit from exceeding the direct reserve on a seriatim basis.

LHATF will expose his proposal and then schedule a conference call to discuss it.

Actuarial Guideline ABC. Having received no comments on its December 2, 2005 draft, LHATF recommended this Guideline, which covers projections of cash values under CARVM in light of the most recent Nonforfeiture Law for Deferred Annuities. ABC must still wend its way through various NAIC Committees for formal approval.

Revisions to Model Variable Annuity Regulation. Having received no comments on its November 10, 2005 draft, LHATF recommended this revision, which aligns it with the most recent Nonforfeiture Law for Deferred Annuities. The revision must still wend its way through various NAIC Committees for formal approval.

Disclosure of Extra-Contractual Amounts. Nothing has been done on this issue, LHATF will schedule a conference call to discuss it.

Electronic Filing of Actuarial Opinions. The goal is to have these actuarial items filed with the electronic filing of the annual statement. Before he left, Mark Peavy prepared a list of required actuarial opinions and certifications. Surprisingly, there are almost 20, including both life and health. LHATF will schedule a conference call to discuss how to achieve this goal.



Report on SOA Preneed Mortality Experience Study. Data tabulation is well under way. SOA will issue a report at the June meeting.

Other Matters. Development of a new Cancer table is progressing.

LHATF is encouraging electronic delivery of its monthly notes instead of hard copy.

Frank Dino (FL) is retiring after a long career in insurance regulation. He was instrumental in the development and adoption of Guidelines 33 and 34, among other things.

Mike Batte wrapped up the meeting by singing the closing theme song from "The Mickey Mouse Club". It was a fine coda to his opening performance of yesterday.

Donald P. Maves, FSA, MAAA

6 March 2006

