

**Thursday, December 7, 2006: Life & Health Actuarial Task Force**

LHATF had a packed agenda for its two-day meeting, but managed to cover it all in the allotted time frame.

Report from the AAA Life Reserves Work Group. LRWG recommended the following changes to the Model Regulation:

- Exclude certain lines of business, such as credit life, industrial life, pre-need and final expense policies,
- Allow a Commissioner the right to exempt a product in a drafting note,
- Define the accumulated deficiency as the negative of the accumulated assets, thus eliminating the need for a “Working Reserve”,
- Emphasize the impact of aggregate margins and consider defining a prescribed minimum for the aggregate margin,
- Give additional guidance on calculating the Margin Ratio (i.e., the old “Z-factor”),
- Expand requirements for determining margins on non-guaranteed elements (NGE),
- Define additional approaches to use the stochastic modeling exemption,
- Require a best estimate assumption for prescribed assumptions,
- Apply the quantification of margin impacts to mortality, policyholder behavior, expenses and asset returns
- Prescribe net spreads and an aggregate cap on reinvestment assets,
- Incorporate the treatment of fraternal benefits similar to their FIT treatment, and
- Add requirements for the determination of starting assets.

LRWG also recommended these changes to AG PBR-VAL:

- Clarify which risk factors are prescribed, which ones must be modeled stochastically, and what the required level of granularity is for setting assumptions,
- Put much of the guidance on policyholder behavior assumptions into an ASOP,
- Modify the description of the credibility method for mortality assumptions and define the best estimate assumption,
- Provide more details on how to determine asset default assumptions,
- Remove the prescribed Treasury rates for the Deterministic Reserve, and
- Define the prescribed path of equity returns for the Deterministic Reserve.

Regulators then commented on the changes:

- Larry Bruning (KS) wondered why certain lines of business should be excluded; LRWG responded that the initial implementation should be as simple as possible,



- Mike Cebula (NY) remarked that the equity return requirements could be an incentive to hold riskier assets; LRWG countered that it was true only for the deterministic scenario,
- Mike Boerner (TX) wanted to know how valuation mortality would be chosen in light of anti-selection; LRWG replied that annual justification is necessary, and
- Some regulators had reservations about the Commissioner opt-out.

LRWG then discussed what it considers the remaining critical issues for which it seeks LHATF input.

1. Definition of accumulated deficiency, and what should be covered by reserves and by capital.

LRWG believes that its recommendation covers situations of positive cash flows arising after early deficiencies, covers situations of intermediate cash flow deficiencies, and works equally well for products with cash values and those without cash values. NY cited many products that do not have redundant reserves (LTC, SPIA, GI life). NY was the only holdout to eliminating the working reserve, preferring to set it equal to the cash value.

2. Quantifying the aggregate impact of margins.

LRWG proposes to calculate a Margin Ratio equal to the reported reserve less the best estimate reserve, divided by the present value of RBC requirements. Bruning questioned how future RBCs would be calculated, since there is a factor that is applied to reserves. How would future reserves be calculated? Do we end up with “stochastic on stochastic” calculations that quickly become unmanageable? E.g., when projecting future reserves, if we have 100 scenarios in year 1, do we then have 100\*100 scenarios in year 2, 100\*100\*100 in year 3, etc.? Cebula questioned how regulatory oversight could be compressed into one number.

3. Policyholder behavior assumptions when data are lacking.

LRWG does not believe that a 100% efficiency assumption is appropriate. Cebula agreed, but cautioned that the assumption should be set at the conservative end of plausible outcomes, should vary by product and should depend on the level of surrender charges.

LRWG finished with a list of outstanding tasks:

- Put new reserve requirements into the Valuation Manual,
- Set implementation and transition rules,
- Establish the CTE level,
- Finish requirements for hedge modeling,



- Complete the deterministic interest rate and equity scenarios and the calibration standards for the stochastic scenarios,
- Determine the prescribed net spreads on reinvestment assets,
- Model and analyze additional products, and
- Incorporate any modifications needed as a result of discussions with Treasury.

Cebula requested consideration of reinsurance, taxes and discount rates (so as not to encourage risky assets).

LHATF voted to expose the revised regulation and guideline for comments, with NY the sole dissenting vote.

Report from Various AAA Work Groups. Donna Claire indicated that the Valuation Manual will be in good shape by March. She also reminded people of the upcoming webcast on December 15 and the overall PBA project updates on the AAA website.

These are the highlights of the Consistency WG report:

- Define the reserve as the Deterministic result plus any excess of Stochastic over Deterministic, for FIT purposes,
- Consider removing the word “best” (e.g., “best estimate”) from various definitions, as it implies a level of certainty that does not exist,
- WG continues to debate the role of reserves vs. capital.

The Reinsurance WG is grappling with the following issues:

- The operation of the cash value floor for non-proportional features of treaties,
- How to reflect reinsurer default risk,
- The necessity of a stochastic reserve if the entire tail risk has been reinsured,
- The treatment for an assuming company of NGEs that are under the control of the ceding company,
- Current risk transfer requirements and how they comport with PBA, and
- Other laws that might conflict with PBA.

Other AAA WGs are addressing these issues:

- RBC C-3 Phase 3, applicable to all life insurance, could be effective for 2008 Annual Statements,
- RBC C-3 Phase 4 for annuities has just started,
- ASB is proceeding on ASOPs for PBA,
- AAA has begun work on a Credibility Practice Note, and



- Work continues on accounting and Blanks changes, non-variable annuities, internal governance and PBA review.

Actuarial Guideline VACARVM. The AAA VARWG noted some areas of variance between the current exposure and its August 8 report, and made the following recommendations:

- Rational policyholder behavior need not be interpreted in strict financial terms and could change over time,
- The use of studies involving contracts without living benefits could be used in certain circumstances for contracts with living benefits,
- A cap on revenue sharing is not needed, but if regulators insist on one, it should be based upon prudent best estimates,
- Remove the Option Value Floor, and indicate whether the Standard Scenario is intended to be permanent or temporary,
- Base the Standard Scenario discount rate on year of issue, such as those determined by SVL or AFIR,
- Adjust account value margins for each living benefit and for death benefits, and
- Determine if CTE 75 is appropriate.

The ACLI remarked that the proposal is effectively rules-based and the exposure is still too conservative, but that companies could live with it if nothing better comes along.

LHATF spent a fair amount of time discussing a proposed survey of the top 25 variable annuity writers. The goal is to get company-specific results under the current exposure and evaluate changes to those results under different specified sets of assumptions and methods. The survey is quite extensive.

An interested party reported that he asked his annuity modeling team members to estimate how long it would take to complete the survey. They replied that they could not start until late February, it would take at least 10 weeks including significant model run time, and they would hope to finish by July. The ACLI asked that the survey be distributed to get feedback on the request itself before companies are actually asked to provide results.

LHATF will discuss the proposed survey on a conference call.

Use of the Split of 2001 CSO. The ACLI submitted the only comment, proposing (a) a modification of the two required tests to address policies with less than 10 years of coverage and (b) extension of the certification exemption to the smoker residual table. LHATF deferred any action to a future conference call.

Report from the AAA Work Group on Economic Scenarios. This WG reported that:

- It recommends the use of internal models if they meet the calibration criteria,



- It wants to prevent the use of internal models that provide advantages relative to the LCAS model, and
- It is close to completing the parameterization of the C-3 Phase 1 interest rate model.

Report from the LHATF SVL-2 Subgroup. Bill Weller, representing AHIP, reminded LHATF that certain methods in use for A&H insurance are actually closer to PBA than are life insurance and annuity methods. His concern is that the proposed PBA framework might bring unintended consequences to A&H reserves, so he urged LHATF to be cautious in its scope and applicability for PBA. He also urged LHATF to exclude P&C companies, HMOs and the like from any PBA requirements.

Interested parties added other items of concern:

- The high cost of data submission for pre-need companies,
- Pricing disadvantages for small companies,
- The overly rules-based and costly current framework,
- Lack of blueprint for what is to be accomplished, and
- Inappropriate applicability to Credit Life.

The SVL-2 Subgroup of LHATF plans to schedule two conference calls in an effort to wrap up a draft SVL by March.

Valuation Manual. Mike Boerner expects a complete draft possibly in June but no later than September.

Centralized Examination Office. Larry Bruning indicated that he expects to issue a report soon.

### **Friday morning, December 8, 2006: Accident & Health Working Group**

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

### **Friday afternoon, December 8, 2006: Life & Health Actuarial Task Force**

Report of the A&H Working Group. The AHWG summarized its morning meeting:

- For rating old blocks of individual medical policies, AHWG is dropping its proposal from a year ago and expects to get a “white paper” from some interested parties,
- Because of the Federal LTC Partnership program, states expect a wave of new filings,



- The SOA has just 4 contributors to its cancer valuation table study and is seeking to triple that number,
- A statement on extra-contractual amounts for A&H will be deferred until LHATF has a statement for life,
- AHWG expects to change the A&H Blank opinion, and
- AHWG is revising the LTC experience exhibit to cover non-LTC policies that have some element of LTC in them.

SOA Report on Pandemic Studies. The SOA is developing Delphi studies, expects to issue a report on life insurance in March and then concentrate on health.

Report on SOA/AAA Mortality Experience Studies. Larry Gorski began by stating that the SOA will soon be issuing a list of experience studies currently under way, specifically citing as examples a study of lapse rates for life and annuities under unusual conditions and a study of SPIA mortality split by traditional contracts and structured settlements.

Then he swung into the preferred mortality study. There have been some anomalous results - specifically the 2002-04 experience shows a drop of 20% from the 2000-01 results. As a result, the experience of 7 companies has been dropped because of incomplete reporting of claims or overall volatility. However, the residual results are still likely to show significant improvement from the 2001 Valuation Basic Table – 68% of 2001 VBT for nonsmokers and 85% for smokers. Also, there is a lot of disparity by policy size.

Report on SOA Pre-need Mortality Experience Study. Highlights of this project:

- A formal recommendation will occur at the March meeting,
- Data is less extensive at ages under 60, and
- If the new table does not get approved before the 2001 CSO table becomes mandatory, it would be a cause for concern.

Reinsurance Reserve Credits. Some LHATF members cited concerns with the proposal, including retroactivity, significant costs and administrative burdens and the fact that it is not needed under PBA. Mike Cebula rebutted that PBA is not retroactive, so it does not solve the existing problem.

Apparently because this issue has generated a heap of industry opposition, Chairman Mike Batte (NM) digressed with a remark that he is very much in favor of PBA, but that comments from industry seem to indicate that they want the status quo. He warned that the “forces of evil” (tongue in cheek – maybe) will try to kill PBA.

Industry repeated its reasons for opposition to the reinsurance proposal – significant costs, uneven accounting between ceding company and reinsurer, not solving a widespread problem, and not addressing the real cause which is an unreasonable mortality standard.



LHATF will schedule a conference call to discuss a response to the SAPWG. Because LHATF appears to be almost evenly split on the merits of the proposal, one possible response is just that – LHATF can not agree on a solution.

Disclosure of Extra-Contractual Amounts. This project deals with reporting claims resulting from lawsuits. LHATF intends to follow the recommendation of the Casualty Actuarial Task Force by adding a section to the Notes to Financial Statements.

Report of the AAA Nonforfeiture Improvement Work Group. This group asked for feedback from LHATF on a proposed set of principles. LHATF deferred action to a conference call.

Electronic Filing of Actuarial Opinions. LHATF supports this initiative, but wants electronic filings to exclude confidential opinions.

Other Matters. LHATF will hold a conference call to discuss the model regulation for the 2005 Group Term Life Waiver Reserve Table.

The actions above are the prologue to a whirlwind of activity in 2007, most notably the forces of good and evil preparing for Armageddon (soon to be a movie directed by Mel Gibson).

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