

**Thursday, June 8, 2006: Life & Health Actuarial Task Force**

All but three of the 19-member LHATF group attended this session and a good number of interested parties were also present.

Report from the AAA Life Reserves Work Group. This group (LRWG) recommended a number of changes to the draft Model Regulation for Principles-Based Reserves (PBR) that would:

- Define the approach to project asset cash flows on General Account equities,
- Add considerations needed to reflect special aspects of variable products,
- Permit the option to do reserve calculations on a date preceding the valuation date,
- Provide more detail of how to choose interest rate and equity return scenarios for stochastic modeling,
- Require annual submissions of experience studies,
- Use a consistent definition of “principles-based” for all products,
- Use a consistent definition of “Prudent Best Estimate” (PBE) for all products,
- Require disclosure of the impact of aggregation,
- Require disclosure of the estimated aggregate assumption margin,
- Require disclosure of the embedded spread over Treasuries on starting assets, and
- Prescribe a cap on the aggregated weighted average spread over Treasuries on reinvested assets.

LRWG also proposed some minor changes to the 3 corresponding Actuarial Guidelines.

The group indicated that it intends to address these items next:

- Guidance on the use of actuarial judgment,
- Treatment of non-guaranteed elements, including dividends,
- Equity-indexed UL,
- Hedging, and
- Treatment of small companies.

Several regulators opined that this project is unlikely to be done in 2007, if then. Some regulators will reserve judgment until they see industry data and preliminary results. Bill Carmello (NY) mentioned fair value of liabilities as a yardstick for comparison.

LRWG then asked for feedback on setting margins for PBE, and proposed four possibilities:

- Leave it entirely up to the judgment of the appointed actuary,
- Rely on the appointed actuary’s judgment, but provide formal guidelines describing what the actuary must consider when setting such margins,



- Require caps, floors, ranges and other limitations in addition to the formal guidelines, or
- Use any of the three methods above, but require that individual margins be adjusted if the aggregate impact falls outside a prescribed range or limit.

LRWG recommended the second option, and LHATF grudgingly agreed while reserving the right to change later. Regulators do not necessarily oppose that option, but cited the difficulty of voting for something that they have not seen in action.

Then LRWG asked LHATF members' opinions on GPV (gross premium valuation) versus GPVAD (greatest present value of accumulated deficiencies). Carmello stated that ideally one approach will apply to all products, and that variable annuities must use GPVAD. LRWG recommended GPV for life products, citing tax reasons and the overly conservative nature of GPVAD relative to life, although admitting that other AAA groups lean toward GPVAD for stochastic reserves.

LHATF ended the discussion by voting to expose the Model Regulation and the 3 Actuarial Guidelines with the changes recommended by LRWG, except that GPVAD is to be used for stochastic reserves.

Report from Various AAA Work Groups. This topic was a status report on the myriad AAA Work Groups wrestling with the Principles Based Approach (PBA) to reserves. The Academy's goal is to have PBA ready for adoption by December of 2006. Space does not permit us to go into detail, but the Academy urged interested parties to follow the webcasts (next one is June 22) and go to [www.actuary.org/risk.asp](http://www.actuary.org/risk.asp) for updates on all PBA projects. Highlights from this session are:

- AAA would like PBA to apply retroactively to all business, but LHATF will start out prospectively, and possibly go retroactive later,
- Regulators are still concerned with reserves going "offshore" under PBA, and suggested reduced credit under some circumstances,
- LHATF wants PBA to apply to annuities also,
- Whether to use predetermined scenarios or calibration criteria for determining scenarios remains an open issue,
- The C-3 component of RBC might be modified, but in any case it will apply to all in force policies, and
- There was no time to discuss peer review and governance, so LHATF intends to devote a conference call to those topics.

Interim Table for Preferred and Standard Mortality Classes. A Joint AAA-SOA group has as its goal the development of valuation mortality tables that reflect preferred and non-preferred underwriting classes. An Underwriting Criteria Team is in the process of creating an algorithm for the grouping of similar risk classes. The Team currently has identified various



criteria (e.g., cholesterol, blood pressure, etc.) commonly used, will then assign the relative importance of each one and will then derive a score for each criterion.

Carmello remarked that this could be useful even if a company had no experience of its own.

Once that Team establishes the algorithm, a Valuation Basic Table Team will develop basic tables with multiple preferred classes as the basis of industry experience. There are many issues yet to be addressed, such as data quality, term mortality after the level premium period, term conversions and number of classes.

Interim Proposals Relative to New Valuation Standards. This is the recommendation of the ACLI for a stop-gap between AG 38 and PBV. Highlights of the discussion were:

- Milliman has analyzed the effect of its split of the 2001 CSO Table into Preferred and Non-Preferred on UL, resulting in an 8-14% reduction in reserves on a model office basis,
- ACLI General Counsel ruffled a few LHATF feathers in a letter suggesting that LHATF redirect SOA and AAA efforts to these interim tables,
- Paul Graham smoothed things over in person, but it appears to be an uphill battle for this proposal (although some observers suggested privately that (A) Committee might be ready to move faster on this),
- NAIC General Counsel has ruled that using lapse rates to calculate reserves for UL with secondary guarantees does not violate the Standard Valuation Law,
- The ACLI modified its draft Model Regulation for preferred mortality such that –
  - It is not retroactive,
  - It does not apply to nonforfeiture,
  - It requires that a company must have at least 20% of its business valued on these tables to be in the Preferred classes, and
  - It adds tests of present values of death benefits over both a 10 year and a lifetime horizon.

Carmello insisted that companies using this table must file mortality experience annually. The ACLI did not rule out its support for that, but cited confidentiality and cost concerns.

LHATF voted to expose the ACLI's changes to AG 38, which had been discussed in a recent conference call, and the ACLI's changes to the Model Regulation discussed today, but added NY's filing requirement.

Finally, LHATF intends to schedule three conference calls on (a) the proposed mortality tables, (b) the use of lapse rates and (c) the entire project.

Report from LHATF SVL2 Subgroup. The purpose of this project is to amend the Standard



Valuation Law for PBV. Currently, Mike Boerner (TX) and the ACLI have proposed adaptations of the SVL to accomplish this purpose. Both proposals are similar, having recommended a "Valuation Manual", but TX gives more authority to the Commissioner and ACLI makes it effective if and only if all states adopt it.

TX and ACLI will work to reconcile their differences.

This Subgroup will also construct the Valuation Manual. It will also address how to resolve disagreements between regulators and companies.

Actuarial Guideline VACARVM. The ACLI proposed changes to the CTE level (65 instead of 75) and some changes to the Standard Scenario.

AAA announced the results of a survey on the readiness of companies to comply by the end of 2006 with VACARVM as it currently stands:

- If passed in June, 42 of 58 companies could comply.
- If passed in September, 24 of 58 companies could comply.

Tom Campbell reminded LHATF that Hartford Life had made some recommendations in April. He also noted that CTE 75 goes beyond "moderately adverse" – the stated goal of VACARVM.

Despite the urgings of these interested parties, LHATF voted 11-3 to expose the latest NY draft dated April 14, 2006 - with an effective date of December 31, 2007. That draft does not appear to have any substantive changes.

### **Friday morning, June 9, 2006: Accident & Health Working Group**

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

### **Friday afternoon, June 9, 2006: Life & Health Actuarial Task Force**

Report of the A&H Working Group. Julia Philips (MN) gave a status report:

1. Approved a new premium deficiency reserve proposal.
2. Discussed alternatives to individual major medical rate regulation. Industry wants a specific written proposal; Ms. Philips indicated they could do that.
3. Delayed instituting two potential changes to the Health Reserves guidance manual.
4. Forwarded LTC reporting forms to the Blanks working group.
5. Congratulated the LTC subgroup for making good progress on the LTC principles based reserves project.



Report from the CADTF/LHATF Joint Subgroup. Some time ago, Dennis Lauzon (NY) submitted a draft of the model regulation “Governance for Principle Based Valuations”. Because Mr. Lauzon was not present at this meeting, Bill Carmello (NY) summarized the group’s recent activity. Mr. Carmello explained that during a conference call 4/13/2006, Mr. Lauzon committed to revising and resubmitting the draft. The revision is not yet complete. Mr. Carmello offered that a law is necessary for PBA governance. He would like to see the LHATF/CADTF interaction continue and possibly invite the AAA to join future discussions.

Reinsurance Reserve Credits. “THE MAIN EVENT”. The agenda called for a 15-minute discussion regarding the treatment of reinsurance credits. Instead, a robust 45 minutes of debate was incurred on this topic. The highlights:

Sheldon Summers (CA) summarized his position:

1. A ceding insurer should not be able to inappropriately increase its surplus due to the frequency of payment of the renewal premium. Language to this effect was added to the Q&A section of A-791.
2. In no event may the ceding insurer receive credit for the reinsured portion of the risk in an amount that exceeds the reserve that the ceding insurer would have maintained if such portion hadn’t been reinsured. Language added to paragraph 35 of SSAP 61.
3. A reduction of the deferred and uncollected premiums reported as an asset for reinsured policies must be made even if the frequency of premium payment to the reinsurer is less than the frequency of premium collection. Paragraph 25 of SSAP 61 revised to reflect this.
4. The issue will not just go away once principles based reserving is implemented, since it was decided the previous day that PBR will only apply prospectively.
5. Goal: Obtain LHATF support for the proposed changes in SSAP 61 and A-791, and also gain support from NAIC staff to draft these proposed changes in two pieces: one for A-791 and one for SSAP 61. Each would be submitted as a Form B change.

Industry representatives argued the following points:

1. This should be a Form A change. Form A is used for “substantive changes”, while Form B submissions are non-substantive.
2. There has not been enough time for the industry to respond and flush out all of the consequences of this action.
3. Why should two policies with identical coinsurance agreements, identical amount inforce, identical policyholder characteristics, etc. recognize different reinsurance credits only because the premium payment modes are different?
4. Bill Koenig (Northwestern Mutual) explained that his company had altered its processing so that when gross premium is less than net premium, a reinsurance credit is only taken for the amount of the gross premium they expect to receive. Mr. Koenig argued that the company should get a deferred premium asset for premium that they expect to collect; LHATF was receptive to his comments.



Several regulators supported the need for more time. Larry Bruning (KS) offered that it is appropriate to create surplus via reinsurance for transfer of risk, but not appropriate to do so because of accounting. After hearing comments from other LHATF members, Mr. Summers withdrew his motion to submit the Form B changes and agreed to a conference call to discuss outstanding issues. Bill Carmelo (NY) strongly suggested that the industry provide legitimate examples supporting their arguments to LHATF members prior to the call; John Bruins (ACLI) responded that they would.

Report of the AAA Nonforfeiture Improvement Work Group. Cande Olson, new chair of the Nonforfeiture AAA working group, gave a brief report. Their goal is to develop a white paper looking at the history of the issues, what issues have been solved and what issues are still outstanding. This would be used as a starting point for future work. Ms. Olson encouraged regulator participation in the group.

Report on SOA Pre-need Mortality Experience Study. Roger Annin, chair of the SOA pre-need mortality project, gave a status report:

1. Charge of the group: to develop a basic mortality table specific to the pre-need market. Their charge does not include adding margins to create a valuation table; AAA would be responsible for this.
2. Data from ten companies was used as a starting point for developing the table.
3. The group is very close to finishing the statistical data analysis.
4. Goal is to have a proposed basic mortality table ready by the September meeting.
5. Leslie Jones (SC) commented that they need this table!

Disclosure of Extra-Contractual Amounts. Randall Stevenson (NAIC) noted that there was nothing to report at this time because of a change in position. More time is needed for staff to work through the pertinent issues.

Electronic Filing of Actuarial Opinions. Nothing to report at this time.

Report on International Issues. Rob Esson (IAIS) gave a report on international reporting issues, and how initiatives already underway may change the way U.S. regulates the business. The two main items that could affect the U.S. are International Accounting Standards and International Solvency Standards.

1. International Accounting Standards: Best result, according to Mr. Esson would be if liabilities calculated for general-purpose accounting were calculated in the same manner as those calculated for solvency. Solvency work is the IAIS most ambitious project: one global solvency system could have benefits for U.S. companies.
2. International Solvency: The approach would be Principles Based and link regulation, financial requirements, governance and disclosure. Mr. Esson identified eight solvency cornerstones required to establish a new solvency system.



3. Why should we care about international accounting? FASB desires to converge with IASB. Joint IASB / FASB would result in “global GAAP”. Since SAP utilizes a GAAP framework, the IASB/FASB merger is relevant.
4. Mr. Esson’s PowerPoint presentation will be included in next month’s LHATF mailing

Report from the AAA workgroup on the PBA Review. This presentation was cut from Thursday’s agenda for lack of time. Since the meeting was running ahead of schedule, the PBA Review / governance workgroup gave its report to the LHATF.

Objectives of PBA Review:

1. Provide assurance regarding the PBA Valuation – validate actuarial judgment, confirm compliance, reinforce valuation processes.
2. Promote consistency across companies
3. Provide information for state financial analysis between exams
4. Facilitate state exam and audit work

A discussion followed regarding who should be responsible for hiring the PBA Reviewer, the company or the regulator. A conference call will be scheduled to resolve this issue, and also to illuminate any other issues that the workgroup should consider.

Other Governance issues: According to Donna Claire (AAA), the objectives of U.S. statutory reporting are to protect policyholders and to promote the concepts of conservatism, consistency and recognition. Uniformity in reserves is seen as a key to the success of the Principles Based Approach because of the amount of actuarial judgment involved. Need both a uniform adoption of PBA laws and regulations, and uniform ongoing oversight including reviews, filing and enforcement.

Other Matters. A letter was sent from Carl Harris (Insurance Strategies Consulting) to Randall Stevenson (NAIC) regarding an interpretation of CARVM. LHATF committee members were asked to review the letter and decide if they would like to respond.

Chair Michael Batte (NM) adjourned the meeting without fanfare. After opening Thursday’s meeting with Willie Nelson’s “Momma, Don’t Let Your Babies Grow Up to be Cowboys”, one might have expected “On The Road Again” as an appropriate bookend. But it was not to be.

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