

**Update from AAA Life Reserves Work Group**

David Neve, Chairman of the LRWG, briefly updated LHATF on its activities since the December meeting, all of which are ongoing:

1. Determining the impact of margins in assumptions,
2. Modeling additional sensitivities for the term product,
3. Deriving preliminary results of UL with secondary guarantees modeling,
4. Studying pros and cons of prospective versus retroactive application of the new approach, and
5. Providing additional guidance for the use of actuarial judgment in the Model Regulation and Guidelines.

These activities will be discussed in depth at the March meeting of LHATF.

Neve and Gary Falde, another LRWG member, then discussed three asset-related assumptions. I will cover the highlights discussed on the call, but because of the amount of detail related to asset assumptions, I recommend reading the proposed Model Regulation and Guidelines found on both the AAA and the NAIC websites.

For determining net earned rates and discount rates, the LRWG recommends:

- 1 A cash flow model is needed to determine a path of net earned rates that reflect the net portfolio rate in each interval.
- 2 The path must vary by asset segment and for each scenario.
- 3 The path must reflect actual starting assets, actual starting liabilities, reinvestment and margins for such items as defaults, prepayments and spreads.
- 4 The path of discount rates for each asset segment will be equal to the path of net asset earned rates.

LRWG had these observations about the types of scenarios:

1. The type of scenario depends upon whether the reserve being determined is deterministic or stochastic.
2. Deterministic cash flow projections reflect a single path of Treasury yield curves.
3. Deterministic projections start with the current curve and grade linearly to an ultimately static curve prescribed by the NAIC.
4. Stochastic cash flow projections use stochastically generated paths of Treasury yield curves.



The elements of the determination of the provision for asset defaults are:

1. Prudent Best Estimates of long-term losses.
2. Consistency with type of asset and quality rating.
3. Use of company's own experience to the extent credible.
4. Explicit margin added to expected default costs.

A few regulators had questions for LRWG. Mike Boerner (TX) asked if peer review is pre-release or post-release of earnings. This WG is not addressing that issue. Bill Carmello (NY) wanted a more detailed discussion of junk bond treatment and equity returns, but the WG demurred, saying that it still has more work to do on those issues. Carmello also asked for a "yes or no" answer to the question of whether a company could reduce liabilities by holding riskier assets. Falde indicated that it is possible, but countered that required capital would probably rise.

LHATF devoted the last part of the call to Carmello's summary of his memo about the draft models:

1. He re-emphasized that he wants to prevent potential situations in which investing in riskier assets produces lower reserves.
2. If company experience is partially credible, he wants a clear description of how to blend that experience with an industry benchmark assumption.
3. The NAIC should establish criteria for required data filing to be used to expedite industry experience tables.
4. The project seems to be concentrating on products where most people agree current reserve standards produce redundant reserves. The project must also address products with currently insufficient reserves, such as payout annuities.
5. NAIC should not rely on ASOPs and Practice Notes.
6. The models are permissive in many places when they should be prescriptive – i.e., "the actuary may" should be "the actuary shall".

NY expects to submit recommended revisions to the draft Model Regulation and Guidelines by mid-February. The discussion resumes at the March meeting of LHATF.

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