

Life Reserves Work Group Update

The LRWG reported its progress on setting asset assumptions and the treatment of non-guaranteed elements (NGE) for PBR.

LRWG intends to present revisions to the model regulation and actuarial guidelines at the December meeting of LHATF. LRWG listed the following items still in progress:

- Definition of “accumulated deficiency” and “working reserve”,
- Margins, particularly in aggregate,
- Mortality assumptions,
- Credibility,
- Starting assets,
- Policyholder behavior,
- Additional product modeling, and
- A host of issues raised by small companies.

LRWG has a working draft of changes to Section VIII (setting asset assumptions) of AG PBR-VAL. Highlights of that draft:

- These items relate to default costs for fixed income assets –
 - Sources of data are company experience if credible, available insurance industry data and broad financial market experience, in that order,
 - Experience should be of such duration to include both favorable and unfavorable results,
 - Quality rating categories may be combined if the resulting default assumptions are equivalent to those that would have resulted had there been no consolidation,
 - The actuary may use level default costs that are equivalent to the expected costs over the life of the assets,
 - Default costs should be consistent for similar asset classes within both the starting assets and reinvestment assets, and
 - The actuary must apply greater margins for classes with higher historical variability and for new asset structures,
- The actuary must model the risks of prepayment, extension, call options and put options in a manner consistent with current asset adequacy analysis, and
- Prescribed spread paths on reinvested assets must reflect option spreads and be net of defaults.

Alan Elstein (CT) urged the LRWG to consider these comments about fixed asset experience data:



- The appropriate duration of such experience must be long enough to include spikes in data,
- The time frame should be at least 30 years, and probably longer,
- The argument that “things are different today” is not a good justification for ignoring bad experience of yore, and
- Defaults are not necessarily related to the level of interest rates; e.g., many defaults occurred in the Great Depression when rates were low.

LRWG closed the call with a brief summary of its work on NGEs:

- NGEs include dividends,
- The intent is to replicate how a company actually determines NGEs, but with margins such that reserves would be higher than if there were no margins, and
- The timing of changes to NGEs in modeling would be expected to lag changes in projected experience, as it would in practice.

Bill Carmello (NY) likes an approach of not changing NGEs for the deterministic calculation, but instead adjusting margins appropriately.

LRWG will address all of the issues enumerated above in its revised drafts for December, at which time LHATF will continue the discussion.

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