

Thursday Morning and Afternoon, June 11, 2009: Life & Health Actuarial Task Force

This is a crucial meeting, because LHATF's goals are to pass the Standard Valuation Law and make substantial progress on the Valuation Manual.

Net Premium Reserves in VM-20. ACLI presented an "aggressive but realistic" timetable for its proposal to LHATF, including results of testing by member companies:

- September for scheduled premium products,
- November for flexible premium products, and
- December for a complete documented proposal for all major products.

ACLI continues to have a dialogue with Treasury about tax aspects of PBR, but Treasury tends to give no definitive answers at least until it sees a definitive proposal, if then (witness that there is still no tax guidance on VACARVM).

Mortality Tables and Margins. This project has 2 separate and distinct parts: (a) a new CSO table, and (b) mortality for guaranteed issue contracts.

Since 1941, we have had roughly a 20-year period between new valuation tables (1941, 1958, 1980, and 2001). However, 2001 CSO is already outdated, and there is mixed sentiment on the need for a new table. On the one hand, some companies argue that 2001 CSO has excessive margins and that PBR will not happen soon enough to alleviate reserve pressures and difficulties with reinsurance and letters of credit. On the other hand, some companies cite the cost of moving to a new table after having just incurred the costs of moving to 2001 CSO, not to mention nonforfeiture and tax considerations.

ACLI has not taken a position on the need for a new table. LHATF members seem neutral. Given the lack of overwhelming sentiment for a change, LHATF decided to take no action.

On the second part of the project, the Academy has done some preliminary comparisons of 1980 CSO to 2001 Residual Standard (both on a nonsmoker, ultimate basis) to see if 1980 CSO could serve as a proxy for currently sold guaranteed issue contracts. It has not addressed (a) how to define what business would be required to use 1980 CSO, or (b) the fact that most of this type of business is sold with no distinction based on smoking status.

Payout Annuity Mortality. The Academy has compiled data on its website, indicating the need for a new mortality table, especially noting the significant effects of selection and benefit level. Concerned with potential mispricing and under-reserving by the use of out-of-date experience, LHATF asked the Academy to develop a new table, including projection scales.

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Costs of Default on Existing Fixed Income Investments in VM-20. The Life Reserve Work Group presented a proposed method for setting prescribed default costs with these key elements:

- Default risk measured at valuation date, not purchase date,
- Default costs as a function of credit rating, spread level, and structural risk,
- Asset-by-asset approach,
- 3 components: generic, specific, and constraint,
- Input from company records for rating, option-adjusted spread, weighted average life, risk, and expenses, and
- NAIC-prescribed parameters for baseline costs, historical and current mean spread indices, and threshold rating class, updated periodically.

Larry Bruning (KS) asked LRWG to investigate what happens under the proposal if a company were to sell its entire portfolio and immediately buy it back.

ACLI and other interested parties then countered that the proposal is not realistic, not workable, not simple, but most of all, not appropriate because reserves increase significantly under the current phenomena of unfavorable economic conditions and increases in spreads. Why, they argue, should companies face potential statutory insolvency because of economic conditions that, while admittedly severe, are likely only temporary?

Thus it is back to the drawing board, but some form of prescribed default costs is still the primary option.

AG 33 and Lifetime Income Benefits. An interested party had asked for an interpretation of the appropriate Plan Type under current Actuarial Guideline 33 for guaranteed lifetime income benefits (GLIB) on fixed deferred annuities.

GLIBs have the following characteristics:

- Either inherent in the annuity contract or provided by rider,
- Usually a 40-50 basis point charge,
- Income determined by formula, based upon the account value or a shadow fund,
- Shadow fund, if it exists, accumulated at some guaranteed rate greater than the minimum rate on the account value,
- Annuity benefits deducted from the account value, and
- Lifetime benefits after account value drops to zero.

Thus the rider benefits are the “excess” benefits beyond the date when the account value is exhausted. The Annuity Reserve Working Group (ARWG) proposed 4 possible solutions, but made no recommendation:

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- GLIB “excess” benefits are Plan Type A; all payments in any other integrated benefit stream involving GLIB are Type C.
- Use split discount rates – Type C for benefits when there is positive account value and Type A when there is no account value.
- Use Type A for all GLIB payments, even if it terminates with a full or partial withdrawal, with Type C applicable to the withdrawal amount.
- Bifurcate the benefit into an n-year temporary annuity using Type C, and an n-year deferred annuity using Type A, where n is the period until the account value hits zero.

Since this item is not related to ARWG’s primary responsibility of PBR, LHATF decided to appoint its own subgroup to study the issue.

Standard Valuation Law. ACLI and interested parties emphasized, and LHATF agreed, that state legislatures should receive the SVL and Valuation Manual (as complete as possible) as an integrated package. After rejecting a few minor amendments, LHATF passed the SVL unanimously, although NY abstained, citing the need for further improvements.

Nonforfeiture Improvement. The Academy expects to issue a report by December.

Generally Recognized Expense Table for 2010. LHATF exposed the proposed 2010 GRET tables for comment.

PBR Economic Scenarios Subgroup. The Academy has developed a more robust interest rate generator and calibration criteria. In addition, AAA has released: (a) 10,000 scenarios as of 9/30/08, (b) a scenario picking tool, (c) 1,000 scenarios calibrated to 9/30/08, and (d) a statistics generator.

The Academy now plans to enhance the generator for bond fund returns and the equity generator for automatically updating parameters based upon recent experience.

Hedging Guidance Subgroup. Although updated hedging guidance will appear in a C-3 Phase II Practice Note, this LHATF subgroup will provide additional guidance, with a Q & A list and a proposal for LHATF to review in September.

Friday Morning, June 12, 2009: Accident & Health Working Group

Did not attend, but see the summary report from the LHATF meeting Friday.

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Friday Morning and Afternoon, June 12, 2009: Life & Health Actuarial Task Force

PBR Life (VM-20). NY stated that the concept of a “working reserve” is important and thus intends to submit an amendment defining such a reserve. The level of the working reserve does have some effect on the final stochastic reserve, because the greatest present value does not always occur at the same duration for differing levels.

LHATF rejected a NY proposal to define a margin for prudent estimate lapse rates on UL with secondary guarantees. NY had set the ultimate margin at 0.5%, but provided no supporting data for its choice.

The SOA is conducting a research project to determine the effects on capital and surplus using the current proposals on VM-20 and capital. 12 companies have agreed to participate. The SOA expects to issue results by September.

PBR Process and Coordination. After some routine items on definitions and fitting VACARVM into a Valuation Manual format, LHATF tried to define what risks that reserves should cover and what risks are more appropriate for capital. Maybe because this discussion occurred right before lunch, people included some bizarre items among the serious ones: class action lawsuits, ratings downgrades, a meteorite hitting the earth, and alien abductions. (I do not make these items up, I merely report them. The reader can judge for himself which ones need more guidance.) LHATF will follow up with a conference call.

A&H Working Group Report. The AHWG covered these items at its morning meeting:

- Discussed revisions to the health actuarial opinion section of the Financial Analysis Handbook used by examiners,
- Formed a subgroup to analyze the Pension Protection Act as it relates to LTC benefits attached to life and health plans (such benefits get favorable tax treatment starting 1/1/2010),
- Submitted the Medicare Supplement Compliance Manual to the Senior Issues Task Force, and
- Continued work on the Medicare Supplement refund formula.

PBR Experience Reporting. NY reported that work continues, but not as fast as hoped. The group’s initial focus is mortality reporting.

PBR Reporting and Review. This subgroup exposed revised VM-30 (AOMR) and VM-31 (PBR actuarial report). The major changes to the Actuarial Opinion are: (a) a statement that the reserves meet the laws of the filing state, and (b) a list of states in which the reserves might not meet the requirements, which would require a separate opinion for each such state.

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International Update. LHATF heard a presentation on international developments in financial reporting. Although this might appear at first glance to be a GAAP issue, there are implications for solvency regulation, and thus a need for LHATF to become involved.

PBR Life (cont.). This part of the VM-20 discussion focused on these issues:

- Policyholder “efficiency” and how to define and set margins for it. ACLI argued that setting such margins is difficult because “efficiency” is unique to each policyholder. LHATF responded that “efficiency”, whatever it is, should serve to increase reserves.
- Overall margins versus individual margins. Industry has long argued that the overall margin should be the major concern. NY has correspondingly taken the opposite tack, insisting that individual margins be determined without regard for the overall effect, and proposed a limit on reductions in margins, essentially minimizing any effects of correlation. NY and LRWG will try to iron out their differences.
- Non-guaranteed elements not based on experience. ACLI argued that they should not be included unless approved by the company’s Board of Directors. There was a lengthy discussion about the treatment of dividends to policyholders, but no resolution. NY expects to submit comments at a later date.

LHATF then exposed VM-20 for comments, realizing that there are still many outstanding issues.

PBR Reinsurance. There is still disagreement about how to calculate the 3 elements of reserves - gross, net of reinsurance, and credit. Although LHATF did not break that logjam, there seems to be some hope for a solution acceptable to all.

CA proposed the recognition of reinsurance counterparty credit risk in calculating reserves, but there was no time to discuss it.

Other Matters. LHATF discussed the proposal to apply 2001 preferred mortality retroactively on business subject to the “interim solution”. It still contains the controversial reinsurance provision, opposed by industry, related to premium modes varying between direct and ceded business. It passed in a down-to-the-wire vote (5-4, with 2 abstentions).

Friday Afternoon, June 12, 2009: Life RBC Working Group

C-3 Phase III. Because of the deluge of comments from industry protesting the effective date of 12/31/09, the WG deferred it to 2010.

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Derivatives Collateral Treatment. ACLI proposed treating the collateral as a stand-alone item with designation Type 1 and a charge of 0.4%, and intends to survey companies on the effect. The WG exposed the proposal for 2 weeks, indicating that it intends it merely as a temporary measure for 2009, and that work should continue on a permanent solution.

Other Matters. Work on the ACLI Derivatives Risk Mitigation proposal will continue via a conference call and further discussion at the Fall meeting

ACLI and industry made an impassioned plea for relief on the mortgage experience adjustment factors, citing the unwarranted rise in RBC charges in the current economic climate. This discussion will continue at the Capital Adequacy Task Force meeting.

Saturday Morning, June 13, 2009: Capital & Surplus Relief Working Group

LHATF reported that it passed Model 815 (retroactive preferred mortality) in a close vote, and that it included reinsurance provisions not popular with industry.

Life RBC WG reported that its work on the C3 Phase II Standard Scenario continues, and that it has targeted 2010 for the permanent Mortgage Experience Adjustment Factors changes.

The Statutory Accounting Practices WG expects to take final action on the deferred tax asset issue by the end of this year.

The group will schedule a conference call to discuss what constitutes an emergency or crisis, what triggers NAIC emergency procedures, and what those procedures should entail.

Saturday Afternoon, June 13, 2009: PBR Working Group

NALC, which represents a good number of small life insurers, enumerated various issues that small companies have with PBR, including VM-20, the stochastic exclusion test, and experience reporting. Commissioner Hampton (DC) expressed a willingness to work with NALC on these issues. ACLI observed that its Net Premium proposal would help small companies.

Hampton indicated that the group plans a 90-minute PBR educational session at the Fall meeting, emphasizing the importance of having approvals from a significant number of states and getting uniform adoption.

LHATF reported that:

- SVL passed, but recommended that it go to the states as a package when the Valuation Manual is substantially complete,

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- The major outstanding issues on the Valuation Manual are the initial scope and the Net Premium method, and
- The statistical agent process is nearing completion.

Commissioner Hampton plans a 30-day review and comment period for the SVL, followed by a joint conference call of this group, its parent Solvency Modernization Task Force, and the (A) Committee. If all goes well and (A) Committee approves, then it would go to Plenary in September.

The underlying themes of this session were that state adoption is far from a done deal and that the NAIC and interested parties have a lot of work ahead of them to achieve widespread and uniform PBR approval.

Sunday Morning, June 14, 2009: Capital Adequacy Task Force (CADTF)

Life RBC C-3 Phase III Proposal. Although the proposal will not take effect in 2009, the Life Working Group set a goal to complete it this year so that companies have adequate lead time for 2010.

ACLI Derivatives Risk Mitigation Proposal. This proposal has a temporary modification exposed for 2009, with the goal of having a permanent solution for 2010.

Life RBC Mortgage Experience Adjustment Factor. This item easily was the main attraction in an otherwise routine meeting. In a repeat of the action at the Life RBC meeting on Friday, ACLI and industry pushed for a permanent solution to the problem. ACLI cited the main issues as uncertainty (which the temporary measure does not fix) and volatility (which the temporary measure mitigates to some extent). Chairman Felice (NY) could not guarantee certainty, but allowed that it was unlikely that CADTF would revert to the prior factors.

Health RBC Trend Test Changes. CADTF adopted these changes with no discussion.

Health RBC Medicare Part D Factor Changes. CADTF adopted these changes with no discussion.

C-3 Phase II Results Subgroup. This subgroup intends to look at results from selected companies and have a report by December.

CADTF/LHATF Joint Subgroup. This subgroup plans to have conference calls to investigate differences in methods and assumptions between reserves and capital, and then determine whether such differences are appropriate.

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Other Matters. ACLI has proposed easing RBC requirements on RMBS (residential mortgage backed securities), which have taken severe hits to capital in the current economic environment. CADTF indicated that the Valuation of Securities Task Force will take the lead on this item.

Summary of Meeting Actions

1. LHATF passed the SVL recognizing PBR.
2. LHATF re-exposed VM-20, although many issues remain unresolved.
3. LHATF declined to move on a 2008 CSO mortality table.
4. LHATF completed its work on capital and surplus relief.
5. Life RBC WG postponed C-3 Phase III to 2010.
6. Industry advanced various capital proposals, including derivatives collateral, mortgages, and RMBS.

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14 June 2009

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