Saturday Morning and Afternoon, March 14, 2009: Life & Health Actuarial Task Force

Larry Bruning, recovered from his serious illness, returned to once again chair the LHATF meeting. PBR again was the main attraction, although most major PBR issues up for discussion remained unresolved.

Net Premium Reserves in VM-20. ACLI provided more details of its proposal to simplify PBR calculations. The NP method introduces two concepts foreign to current statutory methods:

- Non-level expenses amortized non-uniformly, and
- Lapse rates tied to premium increases.

The components of the NP reserve concept are:

- A seriatim NP calculation with CV floor,
- If the as-yet-undefined gross premium adequacy test fails, a deterministic reserve compared to the NP reserve in the aggregate,
- If the stochastic exclusion test fails, a stochastic reserve compared to the NP reserve and the deterministic reserve in the aggregate, and
- In each comparison, the winner is the maximum.

There are five prescribed items involved in the NP calculation:

- Mortality, similar to existing tables,
- Lapses, either a prescribed level or a prescribed formula,
- Method,
- Expense allowance, and
- Interest, which would not be the same as current rates.

VL, VUL, and EIUL could require other items.

Because a number of items still lack definitions, such as the gross premium adequacy test, expense allowances, expense amortization, lapses, and product variations, ACLI asked LHATF for feedback on what would be most helpful to aid the decision. Regulators listed:

- Application and results for non-term products,
- Profitability studies of term after the level premium period, and
- The specifics of the gross premium adequacy test, especially how it will apply to UL.

Mortality Tables and Margins. The SOA/AAA Joint Project Oversight Group (POG) presented comparisons of current CRVM reserves under 2001 CSO with “2008 CSO” (the test valuation

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table). 20-year term reserves are significantly lower under 2008 CSO, while whole life and UL results change minimally.

The POG intends to test results using the ACLI's Net Premium method once it is final, and also to add mortality margins for PBR.

LHATF asked the POG to derive tables for guaranteed issue and simplified issue risks.

Industry representatives remarked that the costs of changing valuation tables, including repricing, filing, and updates to internal systems, can run into the millions of dollars, leading LHATF to speculate whether it might be better to make adjustments to 2001 CSO instead of promulgating completely new tables.

Nonforfeiture Improvement. Although most observers agree that the current nonforfeiture requirements do not respond effectively to new products, this project continues to get short shrift because of the concentration on PBR.

PBR Process and Coordination. The Academy Valuation Law Manual Team presented some alternatives on scope and implementation of PBR.

The scope recommendation splits products into three groups:

- Term and UL with secondary guarantees,
- Excluded products – preneed, credit, and non-underwritten group certificates, and
- All others.

Options for implementation (i.e., length of phase-in) encompass:

- Current proposal – term & ULSG – 5-year phase-in; all others – 5 years,
- Term & ULSG – 5 years; all others – open-ended,
- Term & ULSG – immediate; all others – open-ended,
- Term & ULSG – immediate; all others – 5 years, and
- Term & ULSG – immediate; all others - excluded.

Perhaps other periods such as 3 years or 7 years might apply instead of 5 years above.

LHATF will respond at its next meeting.

Standard Nonforfeiture Law. LHATF exposed a new version of this law at its last meeting in an attempt to define nonforfeiture for policies subject to PBR, because the linkage of nonforfeiture interest rates to valuation interest rates would no longer be appropriate ACLI asked for and

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received a deferral of the discussion until the details of the Net Premium method for PBR solidify.

Subgroup Reports. LHATF has some ad hoc subgroups that summarized their respective activities:

- GRET subgroup - changes to GRET factors used in the Illustration Regulation will essentially be dormant until expense reporting under PBR occurs,
- Hedging guidance subgroup - has just formed recently and had nothing to report,
- Economic scenarios subgroup – investigating the sensitivity of reserves to the mean reversion factor.

The Academy indicated that it will release its report on scenario generators, calibration criteria, stochastic scenarios, and the stochastic exclusion test next week. The report will be available at www.actuary.org.

Standard Valuation Law. This item involved a discussion of how to define the products subject to PBR, because the current definitions of “life insurance”, “annuities”, and “deposit contracts” vary from state to state. Bruning wants any products with any form of guarantee, regardless of what the product is called, included.

PBR Life. LHATF had a long discussion about life revenue-sharing provisions, NY wanting to make them consistent with, or perhaps even tougher than, VACARVM. NY argued that events of the last six months call for more conservatism, but there seemed to be little support for this position.

LHATF ended the day with another long discussion, this one on scenario reduction techniques recommended by the Academy. This is a proposal whereby a company could use a lower number of scenarios than prescribed by meeting certain conditions. After some resistance, LHATF finally acceded to the concept, but not necessarily to the method presented.

Saturday Afternoon, March 14, 2009: Life RBC Working Group

C-3 Phase III. The WG established a 60-day comment period for a report from the Academy on C-3 requirements for life products (similar in many ways to PBR). The current work plan is to have something in place for 12/31/09 implementation. ACLI objected to the short lead time, citing the long expected time until PBR becomes effective.

Mortgage Experience Adjustment Calculation Proposal. ACLI has proposed a factor of 100%, compared to the current range of 50%-350%. ACLI requested a 3-year grade-in for companies that otherwise would have a factor less than 100%. The WG will schedule a conference call.

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Derivatives Collateral Treatment. Through a quirk in the RBC formula, collateral on derivatives got a higher charge than the derivatives themselves, which the NAIC fixed temporarily for 12/31/08. The fix needs to be extended to 12/31/09, but perhaps with modifications. ACLI agreed to draft a proposal for discussion.

Credit for Derivative Instruments. The WG expects to receive a report from industry by mid-April, after which it will schedule a conference call.

Sunday Morning, March 15, 2009: Accident & Health Working Group

Did not attend, but see the summary from the LHATF meeting Sunday afternoon.

Sunday Morning and Afternoon, March 15, 2009: Life & Health Actuarial Task Force

The Ides of March, Selection Sunday, day 2 of PBR – the excitement just does not quit.

PBR Reporting and Review. The only item covered here was filing of the actuarial opinion on a “state of domicile” basis versus “state of filing”. After a modicum of discussion, LHATF agreed to defer this item to a conference call.

PBR Experience Reporting. This was a one-shot issue also, with continued discussion on a proposed amendment to provide small companies relief from annual experience reporting requirements. LHATF deferred a decision on this item to the next meeting, although no regulator seems opposed to some form of relief.

Capital & Surplus Relief. This rush project arose at the December meeting and died before the end of the year, at least at the NAIC level. The intent was to provide reserve and surplus relief in light of the economic events of late 2008.

The NAIC has resurrected the project for consideration of future relief, either temporary or permanent. LHATF decided to re-expose for comments its responses for the life items that it supported in December:

- 1a - allow preferred 2001 tables for any 2001 CSO product subject to the Interim Solution,
- 1c - allow 2001 non-preferred tables to be used for determining segments under the Interim Solution, and
- 2 (eliminate artificial constraints on X-factors).

ACLI requested reconsideration of 1b (life) – make Section 8C of AG 38 retroactive.

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LHATF will discuss these items on a conference call. If LHATF approves any of them, they will then go to higher NAIC committees.

A&H Working Group Report. The AHWG took these actions in its morning meeting:

- Recommended non-controversial changes to the Health Annual Statement instructions for AOMR (clarification) and Policy Experience Exhibit (Medicare Part D),
- Excluded active life reserves from the Medicare Supplement loss ratio calculations, and
- Neared completion of a Medicare Supplement refund formula report.

PBR Life (cont.). The Academy submitted a report on a proposed method for setting prescribed default costs on fixed income investments and then spent a good 90 minutes reviewing it. The main features include:

- Asset-by-asset approach,
- Baseline default table based on long-term market data,
- Temporary baseline adjustment, either plus or minus, to reflect the current market environment at the valuation date,
- Permanent adjustment to specific assets, either plus or minus, to reflect risk relative to baseline, and
- Overall constraints to assure minimum defaults and maximum net spreads.

The devil is in the details, and there are a lot of them, too numerous to cover in this write-up. The Academy introduced a number of specific parameters, many with subjective or “placeholder” values, that LHATF must ultimately define and set.

LHATF, seeing this amount of detail for the first time, was not in a position to take any action. However, regulators stated that they appreciated the thorough nature of the presentation and indicated that the report sets a solid direction at which to proceed to solve what has been a sticky problem.

PBR Reinsurance. LHATF again discussed the two main outstanding issues – the need for risk transfer rules, and how to compute ceded credits – but again came to no resolution of either one. LHATF will schedule a conference call for each issue.

Other Matters. LHATF has been asked to advise the NAIC on treatment of credit default swaps, AG IX-B, consistency of interest rate scenario generators between reserves and capital, and treatment of hedging strategies. As if the plate was not already full…

Monday Morning, March 16, 2009: Capital Adequacy Task Force

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In addition to the Life RBC items already cited above (Saturday afternoon), this group covered two other items of note:

- The Task Force formed a joint LHATF/CADTF subgroup to study the interaction of reserves and capital on RBC factors, and
- The Task Force will take a closer look at appropriate RBC factors for securities lending programs.

Summary of Meeting Actions

No major decisions arose from this meeting, but these projects will be key in the near future:

- The Net Premium method for PBR,
- Possible changes to PBR scope and phase-in periods,
- Academy report on economic scenario generators and calibration criteria,
- Scenario reduction techniques for PBR,
- Capital and reserve relief,
- Prescribed default costs for fixed income assets in PBR, and
- C-3 Phase III possible implementation by 12/31/2009.

Donald P. Maves, FSA, MAAA 26 March 2009

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