

Continued Discussion on Guideline 43 Implementation Issues

On Friday November 13, 2009, the life and health actuarial task force (LHATF) held a conference call to continue discussions regarding implementation issues related to Guideline 43. The agenda was as follows:

- 1- Grading of Actuarial Guideline 43 reserves and Exhibit 5a
- 2- Interrogatory 9.2
- 3- Hedging strategies

For Item 1, actuaries are concerned that under current accounting rules, due to a change in reserve method, they would be required to calculate Guideline 43 reserves as of 01/01/2009. Obviously, nobody wants to do this. The following referral has been sent to the Statutory Accounting Principles SAP working group: LHATF would like “.. to recognize the effect of Actuarial Guideline XLIII as a change in method, but have the impact on surplus be based on the difference between the reserves under the old and new methods as of the end of the year rather than the beginning of the year.” The SAP working group will review the matter in December.

Additionally, LHATF agreed that they should offer guidance on what an appropriate phase in method should be. The current proposal is to recognize 1/3 of the Guideline 43 amount at 12/31/2009, 2/3 of the Guideline 43 amount at 12/31/2010 and the full amount at 12/31/2011. At each reporting period, the reserves would be calculated under new and old methods. New issues would use Guideline 43. Additional text may be added to Guideline 43 to describe the phase in method. This will be discussed at the LHATF meeting in December.

For interrogatory 9.2, actuaries are required to describe the reserves associated with various guarantees. In years past, this has been relatively simple, since the reserves for guaranteed death benefits were reported as Guideline 34 reserves and reserves for guaranteed living benefits were reported as Guideline 39 reserves. Now, it is not clear what should be reported in column 6 of interrogatory 9.2 (the gross amount of reserves associated with a particular guarantee). Tom Campbell suggested that this value could be calculated as the difference between the total reserve and the basic adjusted reserve, for each policy that has a particular guarantee. LHATF agreed that this might be appropriate.

Item 3 proved to be the most interesting. E&Y raised this issue. Essentially, the conditional tail expectation (CTE) calculation suggests that a clearly defined hedging strategy (CDHS) can be modeled when calculating the CTE amount. Guideline 43 basically assumes that if you have a CDHS, you will lower your projected CTE amount. Guess what. Companies are finding out that this is not necessarily true. The cost of the hedging program may actually increase reserves. The questions raised were: Do I have to include my projected hedging if it increases my reserves? Do I include my hedging program but reduce its effectiveness? LHATF actually seemed surprised by the question, which might lead one to wonder why it was

To view past LHATF conference call and meeting notes, visit www.polysystems.com

asked. One of the regulators opined that you should have the option of including a CDHS if it lowers your reserves, but be required to include it if it increases reserves. LHATF agreed to discuss this issue further at the December meeting.

It is clear that hedges currently held must be included in the calculation of the CTE amount and the standard scenario amount. I always thought that modeling hedges was optional for Guideline 43 (i.e. do it if it helps). The regulators argue that this is a projected cost to the company. But, I would argue, do you want companies to hedge these products or not?

Timothy P. Gaynor, FSA, MAAA

16 November 2009

To view past LHATF conference call and meeting notes, visit www.polysystems.com



30 North LaSalle Street • Suite 3600
Chicago, Illinois 60602-2506
Voice: 312.332.5670
Fax: 312.332.2391