

Wednesday Morning and Afternoon, March 24, 2010: Life & Health Actuarial Task Force

Neither rain, nor snow, nor sleet (all of which Denver had the day before) will keep LHATF from its appointed rounds. Despite the weather, almost the entire task force attended, plus a good number of interested parties.

Over the next 3 ½ days, we witnessed cracks in the PBR armor, saw delays in various capital items, and learned that running naked can sometimes be a good thing. But you will have to read below to see why.

Mortality Tables and Margins. Tom Rhodes (MIB) began with a presentation on credibility theory, intended as a teaching session for both regulators and interested parties. He mentioned two methods that could have applicability to PBR - Limited Fluctuation and Buhlmann Empirical Bayesian, which would both address four main types of uncertainty:

- Random fluctuations,
- Mis-estimation of experience assumptions,
- Inappropriate trend assumptions, and
- Uncertainties with interactions of assumptions.

Mary Bahna-Nolan, representing the SOA/AAA Joint Project Oversight Group (POG), summarized its recent activity:

- Mortality table mapping is now part of the Net Premium Reserve (NPR),
- Companies can use supplemental data from reinsurers for credibility purposes,
- Actuaries may use judgment to adjust the applicable industry/VBT tables, with a one table adjustment, higher or lower, permitted with documentation,
- The POG modified the approach for determining prudent estimates, and
- Blending factors are functions of the credibility factors.

The POG is considering these items:

- Incorporating higher margins in the absence of credible experience,
- How not to penalize small companies,
- Covering 85% of contributed experience could be too conservative, and
- Valuation Basic Tables (VBT) should be updated periodically.

The next steps include receiving feedback from LHATF, surveying reinsurers, deriving a basic table based upon 2002-07 experience, and addressing GI and simplified issue mortality.

John Bruins (ACLI) remarked that the industry gets a better tax result with specified loading formulas rather than blended tables.

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LHATF indicated that the process should be such that companies with no credibility use roughly the same mortality assumptions.

Payout Annuity Mortality. The POG has used 2000-04 data to derive preliminary graduated tables for males and females, but data is sparse at the extreme young and old ages. The POG expects to propose tables with projection scales at the August LHATF meeting, but it is unlikely that such tables will vary by benefit amount.

Nonforfeiture Improvement. The Academy Work Group has its tax experts vetting a draft report. It will incorporate any recommendations into a final report for LHATF, but there is no target date yet.

Actuarial Guideline XXV. This Actuarial Guideline covers nonforfeiture values for life insurance with increasing death benefits based on an index, with an exemption for initial face amounts under \$10,000. Since this threshold is woefully out-of-date, the Academy proposed using CPI-U to update the threshold exemption for 2010 (about \$16,000) and then increasing annually.

LHATF exposed the Academy draft for a 30-day comment period, after which it will discuss on a conference call.

Net Premium Reserves in VM-20. ACLI described the process for non-fund and fund products. The process for non-fund products remains unchanged from prior meetings and calls.

Fund-based products with no secondary guarantees use the current UL CRVM process, but with a modified expense allowance.

Fund-based products with secondary guarantees in excess of five years assume a level premium for the SG period, a modified expense allowance, higher interest rates than current CRVM, and lapse rates ranging from 0%-3%.

LHATF raised the following concerns:

- Does the proposed expense allowance reflect current company experience?
- Will a typical UL w/SG product have lapses higher than the Canadian study?
- Are the resulting reserves adequate?
- How does it handle GI and simplified issue products?

ACLI promised to respond quickly to those questions.

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Ad Hoc Discussion on PBR. LHATF finished the morning agenda early, and the Academy asked for some time to discuss general concerns about PBR. Donna Claire (AAA Life Practice Council) listed some items that should be part of PBR, such as a feedback mechanism, auditability, and reliance on SOA studies and research.

Then she stated the Academy's concern that developments over the last two years have become less than optimal, citing:

- It will be expensive to implement,
- It appears to be just one more regulatory tool that companies must complete,
- Setting margins on each assumption is problematic, and
- Elimination of aggregation among products removes natural hedges.

Dave Neve, speaking for LRWG, echoed those comments, stating that the approach has become too conservative and too rules-based. When asked for specific examples, he gave a lengthy list:

- Lack of aggregation,
- Levels of conservatism in revenue-sharing,
- Individual margins on each assumption,
- Not using companies' own stochastic generators,
- Scenario calibration changes,
- Prescribed default costs, and
- Preservation of reinsurance risk transfer rules.

Larry Bruning (KS, and LHATF Chair) launched a brisk rebuttal, saying that, yes, LHATF has micro-managed, but that is the nature of the beast. Commissioners have asked for "guardrails" and LHATF has provided them. The responsibility for solvency carries with it the necessity of getting good but conservative answers.

Then we went to lunch.

Default Costs on Fixed Income Investments in VM-20. The Academy presented its promised amendment to VM-20 to incorporate its proposed default methodology for fixed income assets with NAIC designations. Space does not allow a complete description, but the major components are:

- A baseline default cost from a lookup table, based on PBR credit rating and weighted average life (WAL),
- A spread-related factor, based on a blending of current market spread and historical, also using PBR rating and WAL, graded to zero in the fourth year, and

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- A maximum net spread adjustment factor, based on model segment, also grading to zero in the fourth year.

The Academy also provided all necessary tables for the calculations in an appendix, a list of company-specific inputs needed for each asset, and a method to determine the PBR credit rating.

The Academy also recommended that the determination of reinvestment spreads be based on actual market spreads graded to historical spreads.

NY remarked that the amendment actually makes the process clearer than discussions at prior meetings.

LHATF voted unanimously to adopt the amendment, but reserved the right to review and change the tables in the appendix.

Margins on Assumptions in VM-20. The LRWG discussed its analyses of using various margins on mortality, lapses, interest, and expenses. LHATF reversed its position of prescribing margins, instead relying on actuarial judgment and disclosure, although the mortality POG will address margins.

PBR Life (VM-20). While LHATF considered an amendment that clarifies that the stochastic and deterministic exclusion tests apply to all products, NY proposed applying the tests to competitive term and UL with SG, with all other products using current CRVM. This would reverse an established LHATF policy, and LHATF rejected the proposal.

LHATF also adopted the ACLI's amendment implementing NPR, but also indicated that it needs more review.

Thursday Morning, March 25, 2010: A&H Working Group

Did not attend, but see the summary from the next session.

Thursday Morning and Afternoon, March 25, 2010: Life & Health Actuarial Task Force

PBR Reporting and Review. LHATF considered various amendments to VM-31, but took no action of note. LHATF agreed to expose the working draft of VM-31 for comments.

Report of the A&H Working Group. The AHWG reported these items from its morning meeting:

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- AHWG updated the Medicare Supplement Compliance Manual, which now goes to the Senior Issues Task Force,
- The project to update the 1985 Cancer table is stalled because of a lack of data, and
- AHWG approved VM-25.

The report did not include agenda items A&H Policy Experience Exhibit, rate filing guidelines, LTC, and the Med Supp refund formula.

Variable Annuity Statutory Framework Review. Oliver Wyman, a consulting firm, previewed a soon-to-be-released position paper with observations on VACARVM and C-3 Phase 2. The paper reflects results as of December 31, 2009 from 12 of the 20 largest VA writers. Wyman cited these areas as needing potential corrective action:

- Potential disincentives to hedge risks exists (for example, “running naked”, or not using any hedging, produces lower statutory requirements in high volatility environments),
- The Standard Scenario floor seems to dominate,
- Sensitivities of results are not always aligned with the underlying risk fundamentals,
- Capital requirements tend to be volatile and pro-cyclical, and
- Aggregate reinsurance produces odd patterns in the Standard Scenario.

Oliver Wyman does not recommend dumping AG 43, but instead suggests that LHATF consider some (as-yet-unknown) fixes. LHATF appreciated the feedback, and will consider investigating the results and potential changes with the aid of interested parties.

PBR Process and Coordination. Cleanup work on VM-00 and VM-01 continues.

PBR Experience Reporting. LHATF began to consider amendments to VM-50 and VM-51, but stopped when ACLI objected that experience reporting is not an audit tool and should apply to large companies only. Tom Rhodes recommended a 5-year moratorium on collecting data from small companies. Although LHATF did not reach a conclusion on this issue, and did not add any amendments, it did re-expose both VM sections for comments.

PBR Scenarios. On a January conference call, the LHATF Scenarios subgroup rejected the Academy’s recommended Mean Reversion Parameter (MRP), based on 50+ years of historical rates, for one weighted toward current rates. NY cited a concern that the Academy’s MRP does not generate enough “go low and stay low” interest scenarios.

ACLI argued that the subgroup’s choice produces more volatility, and does not adequately line up long-term rates with long-term liabilities. NY countered that interest rates have not been as high as the Academy’s proposed MRP of 5.5% for at least ten years.

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After a long and spirited discussion, LHATF adopted the subgroup's recommendation.

Other Matters. The final five minutes saw LHATF agree to re-expose VM-20 for comment with all amendments made to date, and David Neve make an urgent plea for reversal of LHATF's previous decision on an aggregation approach.

As you can see, there are major PBR issues on which LHATF and the industry differ significantly. The next five months will be crucial toward getting a VM-20 that both sides can support.

Thursday Afternoon, March 25, 2010: Life RBC Working Group

C-3 Phase 3 Proposal. ACLI and AAA submitted comments on the exposure drafts on Instructions and Scope. NY indicated that it plans to comment by April 10. Then Chairman Philip Barlow (DC) will construct a comprehensive list of issues requiring attention.

The Life RBC WG plans to follow LHATF's lead on scenario generators, which, as we have seen, is quite controversial.

Barlow announced that C-3 Phase 3 can now be implemented no earlier than December 31, 2011.

Derivatives Risk Mitigation Proposal. ACLI plans to respond by the end of May to issues raised by regulators on a late December conference call. The main ones are (a) CDS maturities mismatch, and (b) a proposed change to Total Available Capital from NY. This project will not be in place for 2010.

Commercial Mortgage Loans. ACLI submitted an updated proposal, indicating that it is a "work in progress". ACLI also plans to present results of a statistical analysis by the end of the 3rd quarter. This project is likely to extend beyond 2010.

C-3 Phase 2 Results Subgroup. The subgroup presented five observations, with recommended improvements. LRBCWG will discuss the recommendations on a conference call, but these are the observations:

- December 31, 2008 results appear low,
- Current disclosures do not provide enough information for an accurate qualitative evaluation,
- The development of lapse assumptions on in-the-money GLBs varies widely,
- Total Asset Requirements (TAR) in excess of cash values are volatile when the market is volatile, and

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- Companies do not identify risk mitigation programs if not taking credit.

Friday Morning, March 26, 2010: Regulatory Modernization Task Force

This group, composed of Commissioners, is a voice for state regulation versus Federal oversight. In light of Federal activity in the last week, the discussion was quite timely.

A panel of four state legislators vigorously supported state regulation of insurance. They worry about the Health Care bill signed into law this week by President Obama, not because they oppose it, but because they still do not know all of the provisions that are in it and how they affect insurance. The second item of concern is the Federal initiative announced by Senator Dodd for tighter regulation of the financial industry.

Another goal of this group is to make state regulation more effective and consistent across states. To address those concerns, two insurance industry executives, at the behest of the Task Force, cited areas needing improvement:

- Difficulties of company expansion into additional states,
- Electronic statement filing,
- Inconsistent application of DTA (deferred tax asset) accounting,
- Product approval,
- Inconsistent investment requirements, and
- Agent licensing process and costs.

Saturday Morning, March 27, 2010: Capital Adequacy Task Force (CADTF)

In addition to the report of the Life RBC WG actions described above, CADTF covered these items of interest to life and health actuaries:

- For its 2010 working agenda, CADTF added a study of raising the Life RBC Trend Test to 300% from 200%, and expects to add something on Health Care reform,
- After hearing the update on C-3 Phase 2 and a reference to the Oliver Wyman report, both described above, CADTF reiterated the need to continue working closely with LHATF, as capital and reserves become increasingly perceived as two sides of the same coin,
- After an update from the Solvency Modernization Subgroup, CADTF discussed the differences between regulatory capital (a solvency floor) and economic capital (what companies actually manage to), and noted that insurance solvency regulation has worked well compared to banks, and
- CADTF expects to address RBC for Fraternalists in 2010.

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Summary of Meeting Actions

1. The Academy expressed dissatisfaction with the direction of PBR.
2. C-3 Phase 3 will not happen until 12/31/2011, and other RBC items have been similarly deferred.
3. AG 43 and C-3 Phase 2 seem to produce anomalous results and could entail corrective action by both LHATF and CADTF.
4. LHATF passed VM-20 amendments for the Net Premium Reserves and fixed-asset default costs, apparently accepting the general structure of each; however, LHATF reserved the right to change either as necessary upon further study, and
5. LHATF accepted the recommendation of its Scenarios subgroup to use a scenario generator emphasizing recent experience instead of the Academy's generator based on longtime historical data.

Donald P. Maves, FSA, MAAA

29 Mar 2010

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