

VM-20

The group began with a discussion of an ACLI-sponsored amendment to remove the serialim calculation of deterministic reserves, since the current comparison between net premium reserves and deterministic reserves is performed in aggregate for groups of policies. LHATF delayed taking action when considering the proposed method to allocate reinsurance aggregate cash flows, referring it to the Reinsurance Subgroup.

The main focus of the call was the second item – reinvestment spreads and default costs. The Academy split the outstanding issues into tiers of importance.

The first, or most critical, tier contains these propositions:

- Long-term spread assumptions should be based on real historical data,
- The basis should be the mean of the historical data, regardless of period,
- Reinvestment asset quality and risk level should be consistent with industry average credit quality, liquidity, and other such items,
- Default costs for reinvested assets should be the same as those for comparable starting assets, with the same margins vs. actual default losses, and
- The purchasing of new investments should start with current market spread conditions and grade to long-term conditions over a modest period such as three years.

The second tier contains these important but less critical items:

- Historical observation period,
- Which corporate sectors to reflect,
- Relationship to Treasury rate levels (possibly a Tier 1 issue),
- Exact proxy for industry average asset mix and risk level,
- Standardized reinvestment yield assumptions vs. latitude in setting assumptions, and
- Interest rate swap spreads.

The third tier issues, not discussed, relate to implementation and drafting.

NY wanted to set conservative assumptions. Some LHATF members asked why stochastic testing was even necessary then, advocating such testing as more “real world” than merely setting conservative assumptions. NY countered that true “real world” methods require spreads to be stochastically modeled also, and no one was enamored of that. ACLI declared that it is critical to base spreads and defaults on long-term historical data.

Time ran out, so LHATF plans to continue the discussion on July 22.

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