

REGULATORY UPDATE

Mike Boerner, ASA, MAAA
Managing Actuary
Actuarial Division, Financial
Program

Albert Sekac, FSA, MAAA
Senior Life Actuary
Actuarial Division, Financial
Program

Jo Beth Stephenson
Actuarial Examiner
Actuarial Division, Financial
Program

REGULATORY UPDATE

Topic Categories

- **LIFE**
- **HEALTH**
- **SPEED TO MARKET**



REGULATORY UPDATE - Life Topics

- **AG 38 – Secondary Guarantees**
- **C3 – Phase 2**
- **SVL – 2**
- **General Nonforfeiture Project**
- **Annuity Nonforfeiture - Rule**
- **Actuarial Opinion & Memorandum Rule**



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

AG 38 CONTROVERSY - QUESTIONS:

- **WHAT HAPPENS WHEN INTENT LANGUAGE IS ADDED TO BRIGHT LINE EXAMPLES?**
- **IS THE INTENT LANGUAGE FOLLOWED?**



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

INTENT LANGUAGE (AG 38, INTRODUCTION):

“No statute, regulation, or guideline can anticipate every future product design, and common sense and professional responsibility are needed to assure compliance with both the letter and spirit of the law.”



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

INTENT LANGUAGE Continued:

“Policy designs which are created to simply disguise those guarantees or exploit a perceived loophole must be reserved in a manner similar to more typical designs with similar guarantees.”



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

AG 38, PARAGRAPH 8, STEP 4

Provides a ratio to increase the reserve based on excess funding in the shadow. For a shadow this is the amount in the shadow divided by the single payment necessary to fully fund the shadow.



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

AG 38, PARAGRAPH 8, STEP 4

“Single Payment Necessary”

AG 38 assumes that there is no excess funding in the secondary guarantee in order to determine this single payment.



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

EXAMPLE: Maximizing Single Payment Necessary and Minimizing Ratio In AG 38, Par 8, Step 4:

- **Assume Paid-Up Shadow With 5 times the Premium Load In Later Durations And Diminimus Shadow Interest Guarantees For Large Later Duration Premiums.**
- **The Ratio in AG 38, Par 8, Step 4, May Only Be “2/3” vs. A Ratio of “1” For A Paid-Up Shadow.**
- **Is The Intent Language Followed?**



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

- **Life Health Actuarial Task Force (LHATF) Exposed AG 38 Revision For Comment.**
- **Current Exposure Based On NY Proposal.**
- **Directly Affects Paragraph 8, Step 4 Ratio.**
- **Additional Benchmarking Guidance Added.**



REGULATORY UPDATE – Life AG 38 – Secondary Guarantees

TEXAS AG 38 COMPLIANCE REVIEW

- **Initiated On 10-27-2004.**
- **Deadline For Response Is 11-17-2004.**
- **Elicits Examples With Greatest Difference In AG 38 Reserves vs. Traditional Reserves.**
- **Will Share Results As Appropriate To Assist In AG 38 LHATF Efforts.**



Variable Annuity C3 Phase II

C3 Phase I – Interest rate risk for annuities and single premium life, implemented 12/31/00

NAIC asked the AAA to look at the C3 component of RBC for products with equity guarantees

AAA determined no simple way to develop factors, so a stochastic method was proposed.



Variable Annuity C3 Phase II

It applies to both reserves and capital.

It is a Principles based approach.

It utilizes a cash flow modeling methodology.

Scope: All variable annuities except
Modified Guaranteed Annuities

Group Annuities containing GLBs or
GMDBs

Other products that contain guarantees
“similar in nature”



Variable Annuity C3 Phase II

Capital Adequacy Task Force Meeting
Kansas City 8/23 and 8/24

Connection to Other Regulatory Initiatives
Both US and International

IAIS – International Association of Insurance Supervisors (IAIS) Solvency Subcommittee:
Global Solvency Framework with inputs from the IAA – International Actuarial Association



Variable Annuity C3 Phase II

Connection to Other Regulatory
Initiatives Both US and International

IASB – International Accounting Standards
Board

BASEL II- Revised Capital Adequacy
Framework for International Banking:
Technical reserves/capital; Supervisory
Oversight/Approval of Internal Models;
Required Market Disclosure

Sarbanes Oxley – Principles Based Accounting
Approach



Variable Annuity C3 Phase II IAA Solvency Paper Draft

“While the LHATF agrees with the Report’s Recommendation for a Principles Based Approach to Capital Adequacy, further clarification is needed regarding how to apply those principles consistently across product lines.”

LHATF is recommending that the NAIC ask the Academy to participate in a project to develop a more precise RBC principles framework that sets a common foundation for Life, P&C, and Health.



Standard Valuation Law II

Goal AAA Draft

“Over the next 3-5 years, to develop a set of analytic, communication and reporting principles (founded on an Enterprise Risk Management framework) to be implemented in a proposed Standard Valuation (and Capital Adequacy?) for Insurance in the United States.”



Standard Valuation Law II

American Academy of Actuaries Draft

David Sandberg 11/02/2004

PRIORITIES

“Work with the NAIC to develop oversight tools for regulators. This includes validation and review procedures as well as self regulating avenues such as Peer Review, Back Testing, Corporate Governance and Reporting Standards.”



Standard Valuation Law II

State Oversight Issues

The need for regulatory discretion to require more analysis, require the use of alternate assumptions, void hedge values etc.

The development of regulatory review procedures of the cash flow modeling methodology, i.e., an examiner's handbook.



Standard Valuation Law II

Texas Department of Insurance Initiatives

Agreed to take an active role in
addressing the regulatory issues.

Requested the AAA for assistance in this
endeavor.

Draft of auditing procedures by Mr.
Gorski, 11/5/2004.



REGULATORY UPDATE - Life General Nonforfeiture Project

AAA Nonforfeiture Improvement WG

- **Working to address management of nonguaranteed elements (NGE) prior to considering specific changes in the nonforfeiture laws.**
- **AAA NGE Draft Blueprint Dated 8-6-2004.**
- **Timing – Linked To SVL-2.**
- **Plan Approach Basis.**



REGULATORY UPDATE - Life Annuity Nonforfeiture - Rule

- **Development of Rule To Implement Changes to ANFL**
- **LHATF Exposed Draft In October Call**
- **Premium Bucket Approach Out**
- **Texas Looking To Adopt After Session**
- **Submissions Can Be Approved in Interim**



REGULATORY UPDATE – Life Actuarial Opinion & Memorandum

Texas Status

- **Currently in Draft Stage**
- **Plan to Make Applicable For 12-31-2005 Valuation**
- **Exemption of Single State Domestic Companies**
- **Executive Summary**



REGULATORY UPDATE – Life Actuarial Opinion & Memo. Cont'd

General Information

- **May Accept Other State Actuarial Opinions from Foreign Companies**
- **Accreditation Standard**
- **Approximately 10 States Have Adopted**



REGULATORY UPDATE - Health Topics

- **Premium Deficiency Reserves**
- **1985 Cancer Tables**
- **AAA Rate Filing Task Force**
- **Medicare Supplement – Part D Issue**
- **Long Term Care – Limited Pay NFF**



REGULATORY UPDATE – Health Premium Deficiency Reserves

- **Conference Call 11-12-2004**
- **Katie Campbell, AK DOI, Chair**
- **Draft Changes to Health RVs Rule**
- **Creates New Reserve Category for
Premium Deficiency Reserves (PDR)**



REGULATORY UPDATE – Health Premium Deficiency Reserves (cont.)

The Proposed Changes are Intended to Reflect the Following:

- **PDR and Gross Premium Valuation (GPV) are two independent requirements**
- **GPV is the ultimate test for reserve adequacy that reflects a long-term horizon and is performed in the aggregate**
- **PDR is the test for short-term revenue sufficiency that reflects a short-term horizon and is performed on blocks of business defined in a manner consistent with how policies are marketed, serviced, and measured.**



REGULATORY UPDATE – Health Update to 1985 Cancer Tables

- **SOA Developing Plan to Derive Updated Tables. SOA Committee - Sue Rynearson, AFLAC, Chair Stacey Hunter, Colonial, Vice-Chair**
- **Identified Target Companies to Participate in Data Call as well as Policy Characteristics for Consideration**
- **Focus on Individual Cancer - May Also Request Data on Critical Illness Policies**



REGULATORY UPDATE - Health AAA Rate Filing Task Force

Four Solutions Provided For Consideration

- **IMP – Individual Medical Pool**
- **Prefunding**
- **Inter-block Subsidy – Durational Pooling**
- **Inter-block Subsidy – Rate Compression**

LHATF Currently Analyzing Pro/Cons



REGULATORY UPDATE - Health Medicare Supplement – Part D Issue

- **AHWG – Working to develop principles for adjusting future premiums of policies where the prescription drug benefit is removed as a result of Medicare beneficiaries enrolling in Medicare Part D.**



REGULATORY UPDATE - Health Long Term Care – Limited Pay NFF

- **Benefit formula for contingent benefit on lapse for limited pay policies.**
- **Trigger point.**
- **ACLI to work on examples for Winter NAIC AHWG meeting.**



REGULATORY UPDATE

Speed To Market

- **Interstate Compact**
- **Multi-State Effort (TX, CA, FL)**



REGULATORY UPDATE

Speed To Market – Interstate Compact

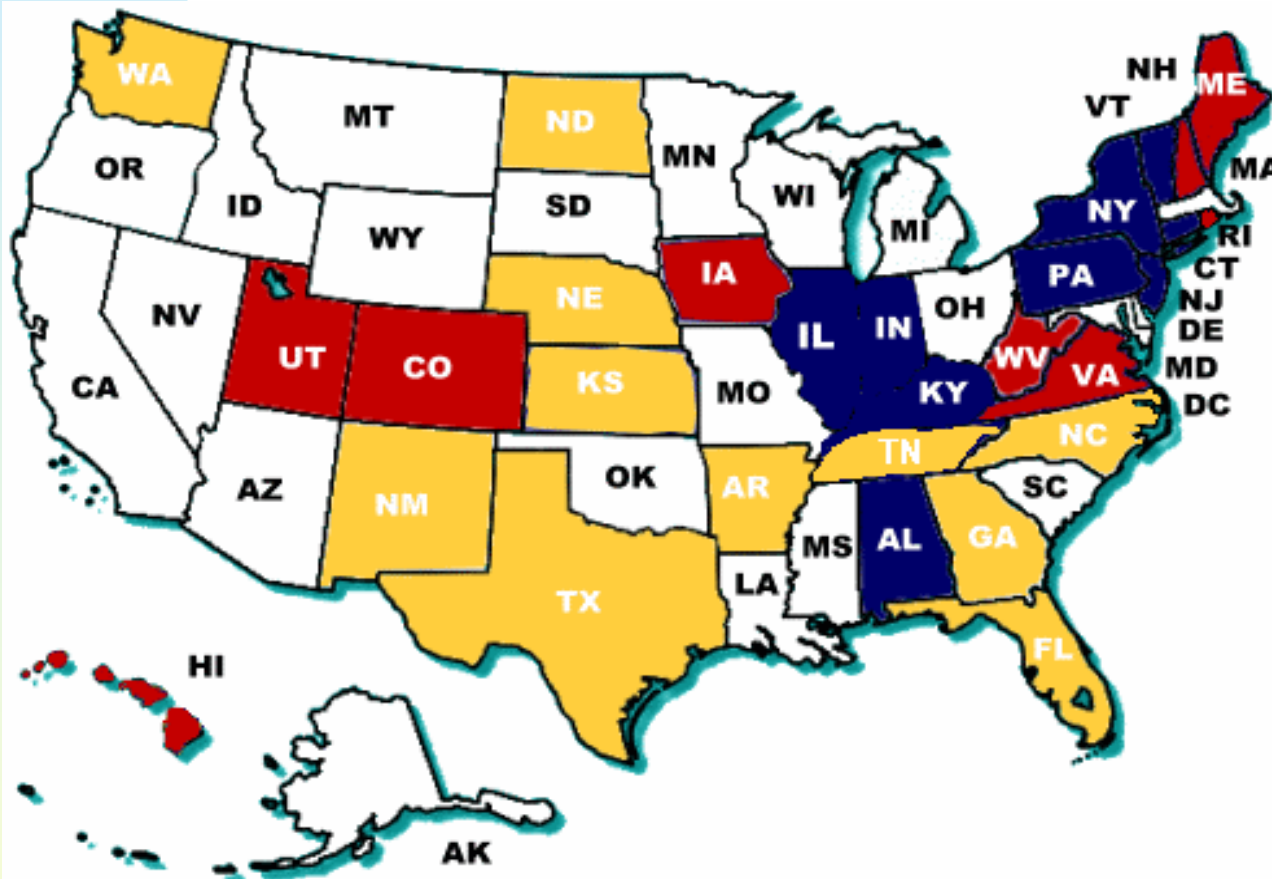
- **Product Checklists To Date**
- **Model Law**
- **State Adoption Status**



- Enacted into Law (9)
CO, HI, IA, ME, NH, RI, UT, VA, WV

- Introduced or Considering Introduction of Legislation 2004 (9)
AL, CT, IL, IN, KY, NJ, NY, PA, VT

- Plan to Introduce Legislation 2005 (12)
AR, DC, FL, GA, KS, NE, NM, NC, ND, TN, TX, WA



REGULATORY UPDATE

Speed To Market – Multi-State Effort

- **Multi-State Effort (TX, CA, FL)**
- **Highest of 3 State Standards**
- **Approvals to Date**
- **Future Checklists**



REGULATORY UPDATE

**TDI Website – tdi.state.tx.us
NAIC Website – naic.org**