

Actuaries' Club of the Southwest
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AG38 Controversy

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Agenda

- Types of Secondary Guarantees (SG) found in products
- AG38 Refresher
- Issue and Interpretations
- LATF statement and definition of “minimum premium”
- Practical challenges in defining “minimum premium”
- NAIC framework – proposal and status

Types of Secondary Guarantees (SG) found in products

UL policy will not lapse even if net CSV (or AV) is less than \$0 if...

- Policy duration is less than 5 years;
- Cumulative Fixed Premium – As long as policyholder has contributed cumulative premiums => Duration x \$/'000 face;
- Shadow Account Fund Value is positive
- Simple – shadow account uses same mechanics as AV, but applies different COI rates, interest, and expense factors.
- More complex – factors vary based on Shadow account balance
- Some designs has 3 tiers of charges, where one set only applies it the shadow account at anniversary is equal to \$0.

AG38 Refresher – History - AXXX

- Interpretation of Model #830 (XXX) = CRVM for Term and UL with Secondary guarantees
- Contains list of “examples”
 - first 7 relate to Term products,
 - 8th relates to Shadow account designs
- Section 8 has 3 parts (A, B and C), that reflect changes in the requirements over the years.
- In 2006, Section 8B was added to address “creative designs” , and to reflect segments that could develop under Term UL, as well as prefunding of guarantees “under each possible segment”

AG38 Refresher – “spirit” language

- “While the Model is a complex regulation, its intent is clear: reserves need to be established for the guarantees provided by a policy. **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.**”
- **Perception that some policy designs “exploit perceived loophole”.**

AG38 Refresher – Process

- 9-step process, with key step being the minimum gross premium;
- Reserve = $r \cdot Ax + (1-r) \cdot tVx$
- Step 1: First, the minimum gross premiums (determined at issue) that will satisfy the secondary guarantee requirement must be derived.
- Step 3: determine the “excess premiums” as the value of the shadow account (which drives “r”)

Issue: How should “minimum gross premiums” be determined when there are multiple charges or credits?

Some companies relied on definition in Model 830, Section 7.A.(4):

“For purposes of this section, the minimum premium for any policy year is the premium that, when paid into a policy with a zero account value at the beginning of the policy year, produces a zero account value at the end of the policy year. The minimum premium calculation shall use the policy cost factors (including mortality charges, loads, and expense charges) and the interest crediting rate, which are all guaranteed at issue.”

Issue: How should “minimum gross premiums” be determined when there are multiple charges or credits?

- A set of year-by-year premiums that satisfies the “zero-to-zero” definition of the shadow account?
- Develop Minimum premium scale for each set of charges and report greatest reserve?
- Illustrated premium scale?
- other approaches?

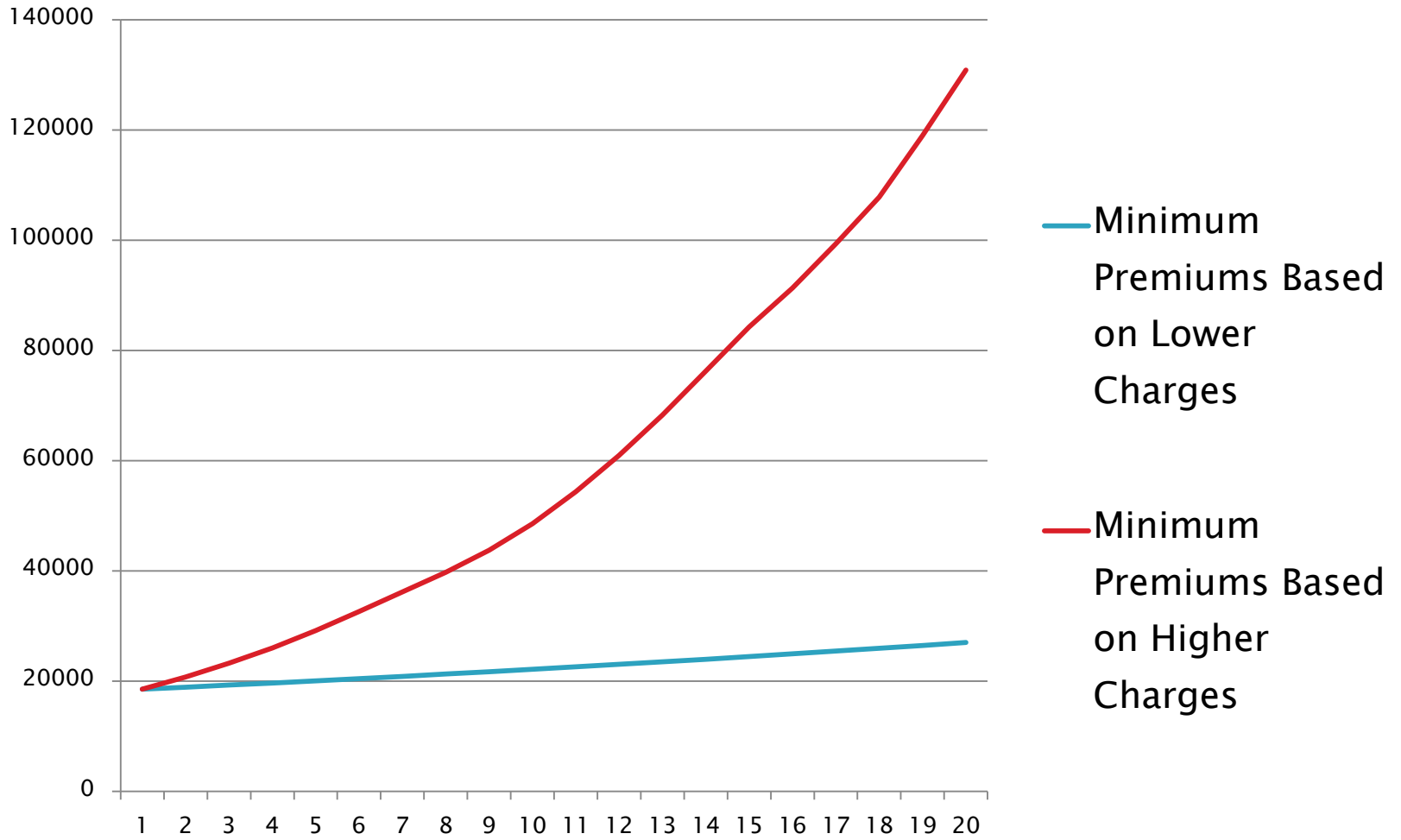
AAA 2006 Practice Note appeared to indicate industry practice relied on \$0-\$0 approach

Impact of using minimum premium \$0.01 higher

New York report (NAIC 2011 Spring meeting)

- example of product with:
 - set of higher charges for when shadow account is equal to \$0 at anniversary,
 - but lower charges for both when the shadow account value is less than or greater than \$0.
- Note: If minimum premium scale = valuation mortality, tV_x is close to 0
- So – if no prefunding, no reserve for the secondary guarantee

Comparison of Premiums



Impact of using minimum premium \$0.01 higher

Some designs appear to :

- Have a set of artificially high valuation premiums in order to lower statutory reserves:
- These premiums don't appear to drive the guaranteed benefit provided to the policyholder;
- Has greater impact on "Term UL"
- Non-level playing field vs. XXX reserves

LATF statement and definition of “minimum premium”

NAIC Life Actuarial Task Force Exposure stated:

“Some companies are holding reserves for universal life insurance products with shadow account secondary guarantees that do not fully reflect the benefits of the secondary guarantees as required pursuant to the NAIC model laws, regulations and actuarial guidelines. . .”; and “These reserves do not properly reflect the full benefits of the secondary guarantee as required by the law, regulation and guideline.”

Exposure on NAIC website at :

http://www.naic.org/committees_a_latf.htm

LATF statement and definition of “minimum premium”

- Adopted statement included recommendation to use “lowest schedule of premiums”
- Cited Model - 830 requirement Section 7.AQ.(2) relating to multiple guarantees:

“When a policy contains more than one secondary guarantee, Model 830 requires reserves to be calculated using the secondary guarantee that produces the greatest reserves ignoring all other secondary guarantees.”

http://www.naic.org/cipr_topics/topic_actuarial_guideline_xxxviii_ag_38.htm

LATF statement and definition of “minimum premium”

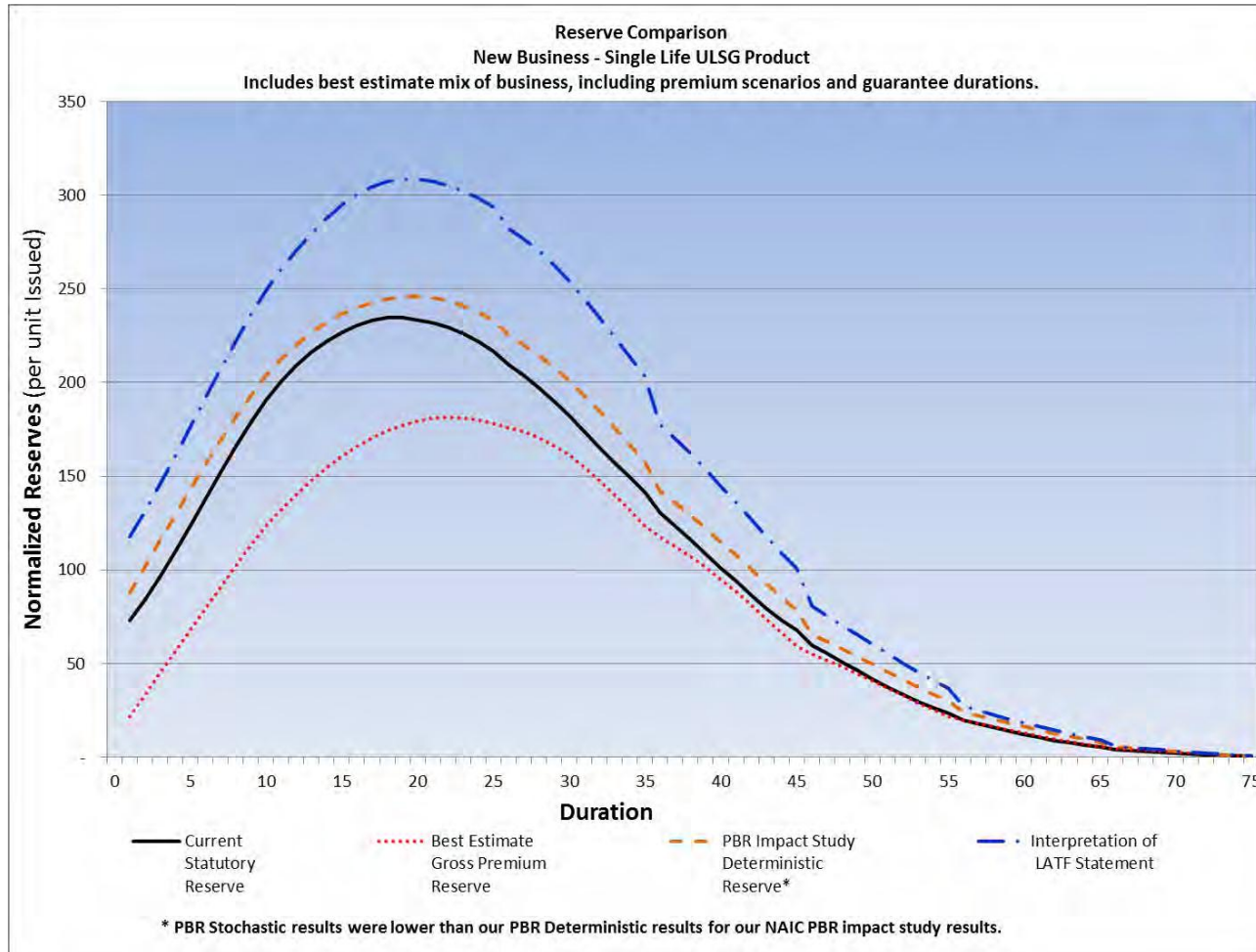
Proposed methodology:

- Test each stream of charges or credits in the policy, as they could result in different secondary guarantee periods

For example:

- increase the premiums by \$0.01 or amount to trigger different set of charges

Potential Impact on Reserves



NAIC framework – proposal

Draft Framework:

Outlined Bifurcated approach

- In force Business – stand-alone adequacy testing of closed block
- Prospective Business – use modified/clarified AG38 until PBR implementation

Exposure draft on NAIC website at:

http://www.naic.org/committees_jt_a_e_wg.htm

NAIC framework – Key hurdles

In force Business:

- How is adequacy defined?
- Do adequate reserves meet state minimum standards?
- How far is it retroactive?

Prospective business:

- How to clarify AG38 so everyone applies it consistently and provides a level playing field for comparable term products?

NAIC framework – Status – In- Force

Per the update provided at the NAIC Financial Summit:

Recommendations - developed:

- scope of business & “start” date for closed in force block

Recommendations - in progress:

- “cut-off” date for in force blocks
- assumptions, and methods for adequacy testing

NAIC framework – Status – New Business

Per the update provided at the NAIC Financial Summit:

DRAFT Recommendations - developed:

- definition of “minimum gross premium” should be clear, concise, not open to interpretation

Recommendations - in progress:

- adjustments to AG38 methodology to tie to use of new definition

NAIC framework – Timeline

Per the update provided at the NAIC Financial Summit:

- DRAFT EXPOSURES targeted for end of June
- Comment period
- Review and modifications
- Possible Adoption by the Joint A&E Working Group and other NAIC groups at August NAIC meeting in Atlanta