Regulatory Update

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Industry Efforts on Regulatory and Legislative Issues

- Interstate Compact (IIPRC)
- Stranger-Originated Life Insurance (STOLI)
- Principle Based Approach (PBA)
  - Reserves (PBR)
  - Capital (C3 Phase 3)
- Capital and Surplus Relief
- Regulatory Reform

IIPRC General Principles

- Compact legislation adopted in 36 states
- Allows an alternative single point of filing with one set of product standards
- States responsible for enforcing contract terms for both IIPRC and state filings
- IIPRC product standards cover policy/contract form, actuarial memorandum and other form filing requirements
### IIPRC

#### Return of Premium Term

- Nonforfeiture compliance is under the new AG 45 which requires:
  - Term policy and rider treated as one
  - Endowment must be funded over endowment period
- Premiums guaranteed during endowment period
- Endowment must be materially less than face amount
- Endowment age/period limited to 80/30

#### Deferred Annuities in General

- Prescribed format for nonforfeiture compliance demonstrations
- Limitation on maturity date in nonforfeiture demonstration (prospective test) to the later of the tenth anniversary or annuitant’s 70th birthday
- Requirement of “betterment of rates” provision
IIPRC
Bonus Annuities

- Must state (if applicable) that bonus benefit may not be fully earned at the time it is credited.
- Bonus forfeiture provision must not allow cash value to go below the minimum nonforfeiture requirement.
- For nonforfeiture demonstration, discount at interest rate 1% higher than the level imputed interest rate that produces a maturity value equal to that produced by the guaranteed bonus/interest rates in the contract.

IIPRC
MVA Annuities

- Can be separate or general account product
- Nonforfeiture for Separate Account MVA
  - Must comply with MGA Model Reg #255
  - Retrospective test is before MVA
  - No prospective test
- Nonforfeiture for General Account MVA
  - Retrospective test is after MVA
  - Prospective test is before MVA;
- Actuarial opinion must state that MVA formula, assets and index are reasonably related
IIPRC
Guaranteed Living Benefits

- Actuarial Memorandum must include examples of how the product works
- Contract must include warning that excess withdrawals could reduce future benefits by more than the value of the excess withdrawals
- Rider can terminate if ownership changes (protection against purchase by institutional investors or life settlement companies)

STOLI

- What is Stranger Originated Life Ins?
  - A life insurance arrangement, in which speculators, who have no relationship to a person, initiate an insurance policy against their life and fund the premium payments for investment purposes.
  - Circumvents the intent behind state requirements for insurable interest at time of purchase; may violate the essential social purpose of life insurance, which is to provide protection.
  - Buyers of these policies include hedge funds and Wall Street banks.
STOLI

- Model Laws that Address STOLI
  - NAIC Viatical Settlement Model Act prohibits settlement of life insurance policies for five years if they exhibit certain suspicious characteristics.
  - NCOIL Life Settlement Model Act prohibits settlement of life insurance policies for two years, and in addition prohibits plans and practices to originate policies by strangers.
  - IIPRC standards allow companies to ask questions on a life insurance application to determine if the purchase is motivated by funding by a third party and/or a promise of a purchase by a third party.

STOLI

- No restrictions on life settlements after 2 years if the policy is purchased in good faith and the owner wants to sell the policy to a “stranger” in order to get maximum value from their policy, usually because:
  - The owner no longer needs the insurance coverage, or
  - The owner has high end-of-life expenses.
- IIPRC standards for both life and basic annuity policies allow such policy sales or ownership changes
STOLI

- Legislative Activity
  - Legislation with 5-year ban passed in 7 states
  - Legislation with 4-year ban passed in 1 state
  - Legislation with 2-year ban passed in 11 states
  - Other legislation passed in 3 states
  - Legislation introduced in another 18 states

Difficult to ascertain how effective laws are in deterring STOLI because:
  - Laws are new
  - Financial activity is down due to global credit constriction (i.e., if brokers package these products, no one will buy them).
STOLI

- New Issues
  - STOLI on annuities is a current concern that was not previously contemplated
  - STOLI and life settlements in general could be a risk to the pricing of Guaranteed Living Benefits on variable annuities, which are possible targets for sale to speculators.

PBA (Reserves & Capital) Overview

- Standard Valuation Law (SVL) has been amended for PBR and was passed by LHATF in June
- Academy working with LHATF on outstanding issues to complete amendments to Valuation Manual
- ACLI working on proposal for tax reserves under PBR
- Effective date for third phase of principle-based capital (life) expected to be 12/31/10
- Effective date for PBR not likely before 12/31/13
PBA
Amendments to SVL

- The SVL as amended for PBR, was adopted by LHATF in June. NAIC “A” Committee to review next.
- The SVL refers to requirements in the Valuation Manual. The Valuation Manual has been updated for PBR, with only a few issues still outstanding. “A” Committee will need to decide if the Valuation Manual is complete enough to adopt the model law.
- Process to begin seeking approval in state legislatures could possibly begin in 2009 and 2010

PBA
Valuation Manual - Outstanding Issues

- **Scope Issues**
  - Should apply only to term and UL with 2ndary guarantees? Or should all products be phased in?
- **Use of prescribed default assumptions**
  - Academy does not support but is working with LHATF to accommodate request and to come up with acceptable solution
- **Use of prescribed interest rate scenarios**
  - Academy believes that companies should be able to use the same interest rate scenario generator for PBR as for C3 capital requirements (based on NAIC-approved calibration criteria)
- **Use of prescribed margins**
  - Academy believes companies should be able to use actuarial judgment; some states want prescribed margins
- **Full aggregation or partial aggregation**
  - Companies want full aggregation; some states want partial aggregation
**PBA**

**Tax Reserves – Net Premium Approach**

- From discussions with Treasury on VACARVM, it is clear that a formula-based methodology would be required to comply with Federal Income Tax Code.
- The ACLI is working on a net premium reserve methodology that will fit this criteria.
- The challenge is to come up with a methodology that comes as close as possible to the deterministic reserve without exceeding it.
- ACLI expects to have a detailed proposal that covers major products by the end of this year.

**Key PBA Dates**

- VACARVM effective 12/31/09
- Capital requirements for life products (C3-Phase 3) probably effective 12/31/10
- PBR for life products (VM-20) no earlier than 12/31/13
Capital and Surplus Relief

- Given the conservatism of current accounting and reserve requirements, ACLI proposed 9 temporary capital & surplus relief items to the NAIC.
- The proposal was not adopted for year end 2008 since more time was needed to review and because it was not the time to reduce capital requirements.
- Several companies received relief from individual state regulators in 2008 under “permitted practices” exemption.
- NAIC will recommend changes for adoption at the June NAIC meeting.

Regulatory Reform

- Three phase approach to solving the current crisis:
  - Fix current problems – TARP, stimulus, etc.
  - Address gaps in system that create systemic risk (e.g. unregulated derivatives market)
  - Comprehensive overhaul of regulatory organization
- Ideas being considered by Congress and Obama Administration
  - Greater focus on economic risk-based regulation & regulatory supervision
  - Systemic risk regulator
  - Increased capital requirements
  - Goal to pass legislation by year end 2009
- Legislation for Office of Insurance Information re-introduced.
Regulatory Reform

- NAIC Considerations
  - Increased transparency in Sch D, regulating CDSs, increased disclosure of collateral & CP risk, modified reporting of securities lending, and reflecting additional market risks in the RBC formula
  - Support of strong role of state regulators
  - Support of formal regulation of holding companies including “supervisory colleges”
  - Support of Office of Insurance Information
  - Acknowledgment of need for some kind of systemic risk regulation

- NAIC regulatory reform focuses on U.S. solution. International convergence has slowed.

Regulatory Reform

- Academy Involvement
  - Academy has submitted written testimony in support of the Systemic Risk Regulator concept and met with Senate Banking Cmte and House Fin'l Services Cmte
  - Academy’s objectives:
    - Promote the actuary’s expertise in risk management
    - Promote regulation based on effective risk management principles
    - Get invited to future discussions
    - Stay out of political issues (e.g. who regulates)
Regulatory Reform

- ACLI Comments
  - Congress can ill-afford to ignore life insurers as it revamps the regulatory landscape
  - Strong federal alternative is necessary, as before, due to:
    - The inefficiencies of the state regulatory system
    - States have no authority to bind the U.S. in global regulatory matters

Status of Optional Federal Charter Legislation

- Reps Royce and Bean recently introduced an updated OFC bill in the House. For the Senate, Sen. Johnson is expected to introduce a companion bill in the near future.
- There is some discussion that the charter would not be optional. ACLI still feels optionality is important and sees no down side. Some critics of OFC think it creates a two-tiered regulatory structure that harms consumers.
- Treasury Secretary Geithner commented recently that there is a "very good case" for a federal charter for insurance.
- While the current financial crisis boosts the odds for a Federal Charter, some Congressional camps are preferring a federal risk regulator at the holding company level, with continued state oversight of the insurance companies.