

NAIC/LHATF TOPICS UPDATE

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Actuarial “HOT” Topics

1. PBR/Valuation Manual (VM)
2. RBC C-3 Phase III
3. AG XLIII/C-3 Phase II RBC – Variable Annuities
4. Patient Protection & Affordable Care Act (PPACA)
5. AG XXV Revisions
6. Nonforfeiture Improvement



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PBR/Valuation Manual

- Version of VM targeted for Plenary August (Seattle)
- Completed: VM-26 (Credit), VM-21 (VA's), VM-30 (AOMR), VM-25 (A&H, current requirements); still substantive work on VM-20 (Life) and VM-31 (PBR Report requirements)
- VM-20 resolved issues:
 - Asset default rates on fixed income investments
 - Stochastic scenario generator (VM-20/C-3, P3)
 - Assumptions/margins for lapse/ph behavior left to actuarial judgment and appropriate disclosure

PBR/Valuation Manual (Cont'd)

- VM-20 issues to be resolved:
 - Net premium reserve methodology for “fund based” and “non-fund based” products
 - Utilizes lapse rates and higher valuation rates for products with no cash values
 - Exclusion tests:
 - i. Stochastic Exclusion Test (2 pieces)
 - ii. Deterministic Reserve Exclusion Test (Net to Gross Test)

PBR/Valuation Manual (Cont'd)

- If:
 - a) i and ii are satisfied, current CRVM is reserve
 - b) if i but not ii is satisfied, reserve is the greater of DGPR and NPR
 - c) i is not satisfied, reserve is NPR plus the excess, if any, of the greater of the stochastic reserve or the DGPR over NPR
- Issues of aggregation for purposes of applying the various tests still remain

PBR/Valuation Manual (Cont'd)

- Recent comments from AAA, ACLI and ALIA on PBR process and deadlines
 - AAA LPC letter sent 5/12/10:
 - i. Concern that framework is overly complex and rules-based; not based on company's own risk assessment
 - ii. Foundation for adequate "feedback loop" not in place

PBR/Valuation Manual (Cont'd)

- ACLI letter dated 5/4/10:
 - i. Concern that VM-20 has become a "complex compendium of formulas, rules and prescriptions"; difficult to call principle-based
 - ii. Initial scope of VM-20 should be limited to term and UL with secondary guarantees
 - iii. Must complete and field test VM-20 adequately before Manual is adopted
 - iv. Concern that PBR "chassis" is being used for other areas even though it has known problems; more time to test and resolve

PBR/Valuation Manual (Cont'd)

- ALIA letter of 5/5/10:
 - i. VM-20 a gradual retreat to a reliance on rules and prescriptive elements
 - ii. Pace of VM-20 completion too aggressive
 - iii. Initial scope of VM-20 should be limited to term and UL with secondary guarantees
 - iv. More field testing is necessary prior to legislative adoption
- Most recent LHATF decision is to study the possibility of and make recommendations for a PBR impact study

RBC/C-3 Phase III

- Implementation delayed until at least 12/31/11
- NAIC LRBCWG receiving input on AAA approach
- ACLI wants to limit stochastic modeling approach to UL with secondary guarantees of more than 5 years
- Also wants traditional products to use a factor approach to determining RBC
- NY wants to apply VM-20 approach; less of a PBA approach than recommended by AAA

AG XLIII/C-3 Phase II

- Oliver Wyman study performed on 12/31/09 AG XLIII VA reserves and C3 Phase II RBC
- Report presented to LHATF in Denver
- 12 largest North American VA writers
- Major findings, some counterintuitive:
 - Required RBC often increased when hedging is present (both actual reserve and stochastic only)
 - Hedging leads to greater instability of capital

AG XLIII/C-3 Phase II (Cont'd)

- Different impact of equity hedging on Standard Scenario amount (↓) than on stochastic (↑)
 - Standard Scenario tends to drive reserve results as compared to stochastic CTE 70 requirement
 - Standard Scenario AG XLIII reserves have opposing and decreased interest rate sensitivity versus stochastic
 - New approach more “market sensitive” than prior
 - Pro-cyclicality and volatility of approach may cause communications problems for life industry
- Oliver Wyman has proposed a follow up study; plan is to propose amendments to current requirements

PPACA

- Many implementation responsibilities have been assigned to states by HHS
- NAIC is coordinating these efforts through numerous of its committees and task forces
- LHATF AHWG is spearheading actuarial aspects of implementation
- Main actuarial areas:
 - Medical Loss Ratio (MLR) requirements
 - Temporary (to 2014) national high risk pool

PPACA (Cont'd)

- MLR's
 - 80% for individual/small group; 85% large group
 - MLR rebate calculation issues – treatment of reserves, LAE, calendar yr/plan year, aggregation, pooling, policy/policyholder level, how paid, claim run off approach
 - Reporting of “unreasonable” rate increases
 - States need to make recommendations to HHS by mid-July

PPACA (Cont'd)

- Temporary high risk pool
 - Available to high risk (have a pre-ex condition) individuals without coverage for prior 6 months
 - No pre-ex exclusion
 - OOP amounts \leq high deductible HSA limit (\$5,950 per individual)
 - “Standard population” rates not varying more than 4:1 by age
 - \$5 billion in federal funds to support states
 - States may opt out; let HHS implement program

AG XXV Revisions

- AG covers minimum reserve and NF requirements for life products with increases tied to an index
- LHATF requested AAA NFIWG to consider changes to \$10,000 threshold amount for minimum NF values
- LHATF adopted NFIWG recommended changes in May; sent to Plenary for August approval
- No changes to AG XXV with respect to minimum reserve methodology

AG XXV Revisions (Cont'd)

- Threshold for minimum NF values remains at \$10,000 for issues thru 2009
- Threshold for 2010 and beyond is \$10,000 adjusted by (CPI-U June prior year/136.0 CPI-U 6/1991)
- Rounded to nearest \$25; Minimum annual $\Delta = \$500$
- Minimum NF values for policies with $FA \leq$ threshold are based on level FA with changes as they occur
- Allows policies with index adjustments to qualify as life insurance under IRC 7702

Nonforfeiture Improvement

- Effort assigned by LHATF to AAA NFIWG
- Involves proposal to revise current life and annuity minimum NF laws
- Logical extension of PBA approach to reserves/capital
- Existing prescriptive/formulaic laws do not handle certain products in today's marketplace well
- Concept is that minimum NF values should relate to pre-funding built up in contract