



AMERICAN ACADEMY *of* ACTUARIES

To: NAIC Life and Health Actuarial Task Force

From: American Academy of Actuaries'¹ Life Financial Soundness/Risk
Management Committee

Subject: Update for LHATF August 4, 2006 Conference Call

Date: 07/04/06

¹ The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

The American Academy of Actuaries' Life Financial Soundness/Risk Management Committee would like to spend our time on the August 4, 2006 LHATF call going over the items that are outstanding regarding a Principles-Based Approach (PBA). The goal is to develop a list of everything that will need to be addressed by year-end in order to meet the LHATF goal of having a PBA available to be adopted by year-end 2006 for newly issued life insurance products. Some of the items are/will be discussed during conference calls; some will be discussed in further detail at the September LHATF meeting, with the goal of having items exposed in September so they can be finalized by December. In addition, there are some items with a longer-term outlook - e.g., certain products could likely be rolled out in the next couple of years. For example, Long Term Care is being worked on, but will not be ready by year-end 2006.

Specifically, the current goals are to have the regulations that support the implementation of life insurance reserves available at year-end 2006, so the new requirements can be rolled out by states beginning in 2007. The capital requirements relative to C-3 risks for life insurance products will be available by year-end 2007. It is expected that PBA reserves for both variable and non-variable annuities will be able to be rolled out by year-end 2007. Eventually, this PBA approach could be rolled out for all life company products, and possibly even to all inforce business as well.

To have these goals achieved, certain items are on the critical path, with major decisions needed from LHATF by the September meeting:

1. **Changes to the SVL law: CRITICAL ITEM.** This was discussed on a conference call on July 31. Larry Bruning's LHATF SVLII Subgroup (and Mike Boerner in particular, with help from a number of other regulators) have put a lot of time into the re-write of the law. It is expected that a version of this law will be exposed for comment (maybe even adopted) by LHATF in September. Some key issues include: third party data agent; how easy or hard to make it for states to opt-out of certain regulations.
2. **Valuation Law Manual: CRITICAL ITEM to initiate:** It is expected that the law will reference the manual for details and regulations. Larry Bruning's LHATF SVLII Subgroup (and Mike Boerner in particular) has been working on the concept of the manual. In order for certain states to pass the law change, the outline of what the manual is expected to cover may need to be available, along with some of the regulations that are in the manual. The manual itself would be a living document that will evolve over time. It is expected that certain sections will be available for exposure at the September meeting, e.g., a table of contents and the parts referring to the LRWG regulation and principles-based review. Also, it is hoped that procedures for approval of changes to the manual (including the initial manual) will be discussed at the September meeting (for example, will changes be adopted similar to the Statutory Accounting Procedures?)

3. **Life Model Regulation and Actuarial Guidelines: CRITICAL ITEM:** This will be discussed on the August 9th conference call, with a presentation by the co-chairs of the Academy LRWG, Dave Neve and Tom Kalmbach. Both the regulation and actuarial guidelines were exposed at the June NAIC meeting. Additional work done by this group will be discussed at the September meeting.
4. **Principles-Based Review Regulation: CRITICAL ITEM:** It is expected that a draft model regulation on this, with work led by Shirley Shao, chair of the Regulatory Interface, Peer Review and Governance Work Group, will be available for exposure by the September NAIC meeting.
5. **Actuarial Examiners Team: CRITICAL to know what changes may be needed in regulatory structure:** The Academy's Life Financial Soundness/Risk Management Committee believes Larry Bruning's idea of a centralized review area deserves discussion. Although it is not necessary to have in place by day one, it would be helpful to know if this is going to happen so that no laws or regulations are set up to preclude this. Some specific questions on this: What functions would be assigned to this Team? Will it have permanent staff? Where will it be located (in a central location and/or in individual states)? Will it function like the interstate compact? Will states voluntarily elect to be in it? How will it be funded? This will be discussed on the August 4th conference call and at the September LHATF meeting.
6. **VACARVM: Critical for implementation in 2007:** The current exposure of Actuarial Guideline VACARVM, which covers reserve requirements for variable annuity contracts, includes an effective date of December 31, 2007. In order to meet this effective date, the guideline will need to be adopted by the NAIC by mid-2007. It is possible that adoption by LHATF can be delayed until March or June 2007, but since many of the issues affecting VACARVM are also applicable to life insurance and non-variable annuity reserves, it is important for LHATF to adopt this guideline by December 2006. To do this, it will be necessary to discuss and resolve the issues raised by the Academy's VARWG in their August report during the August 8 LHATF conference call and the September NAIC meeting, and finalize the guideline either at that meeting or by the December NAIC meeting.
7. **Governance: Direction critical, what needs to happen on Day One?** The PBA concept may be able to work even more effectively if senior management/Company Boards are part of the process. This concept is expected to evolve over time. It will also involve more than the actuaries of the company. The question to LHATF/NAIC is, what is needed on Day One, considering that, on Day One, it would likely only apply to a relatively small percent of most companies' business? Would this be better answered/developed by first evaluating for a few years, how well the minimal governance requirements of PBA guidelines and review requirements function? What other groups of the

NAIC need to provide input on this? Note that Dennis Lauzon will lead a LHATF/CADTF discussion on governance on August 1.

There are also a number of items that are critical to the process, but much of the work is being done by Academy groups at this time. These will be discussed at the September meeting, with input desired from LHATF:

1. **RBC Changes: CRITICAL to implement (but not by LHATF), with some work to be done in 2007:** With the reserves changing, the C3 component of RBC will need to be changed. Peter Boyko is leading this effort as chair of the Academy's Life Capital Work Group. Boyko will provide an update on this project at the September meeting. The CADTF is officially in charge of this. The goal is to have the concepts ready by year-end 2006, with details ready in 2007 in time to implement for year-end 2007.
2. **Consistency Group: Concept Critical as more product lines developed:** Bob DiRico heads an Academy group working on consistency. One of the charges of this group is to make recommendations that allow definitions (e.g., prudent best estimate) to be consistent among the regulations and guidelines. It is expected that there will be a report on this at the September meeting.
3. **Preferred Mortality: Concept Critical, will be ready for adoption in 2007:** In order to know what mortality assumptions are to be used, there needs to be good mortality table data to support the new life insurance requirements. Larry Gorski is heading up the Joint SOA/AAA Project Oversight Group. The Preferred Mortality tables are on track to be available by March of 2007. It is expected that there will be an update on this project at the September meeting.
4. **Other Assumptions, e.g., Lapses: Concept Important:** In order to assist companies in choosing assumptions such as lapses to be used in a PBA world, it is useful to have industry studies. The SOA is conducting a number of such studies, and it is expected that there will be an update on the research at the September LHATF meeting.
5. **Reinsurance Issues: Concept critical:** It is important to ensure that the effect on reinsurance is considered in any regulation changes. Sheldon Summers is heading an Academy work group on this. Two of the major issues that have arisen concern risk transfer and reporting of gross reserves. It is expected that Sheldon Summers will discuss these on the August 4th call or at the September meeting.
6. **How Stochastic Scenarios Are Chosen: Critical for implementation, Input desired from LHATF:** LHATF heard a presentation by Nancy Bennett, representing the Academy's SSMWG on this topic on July 19. This Academy group will share their conclusions at the September LHATF meeting.

7. **Economic Scenarios: Critical For Implementation:** Larry Gorski is heading an Academy group that is developing scenarios to be used by companies. There will be a report on this in September.
8. **Standard Nonforfeiture Law: Critical:** Under a PBA approach where it is expected that mortality tables will be updated frequently, the potential impact on the SNFL needs to be studied. There will be a report on this in September.
9. **Non-variable Annuities: Critical for 2007:** Jim Lamson is heading the Academy work group looking at PBA requirements for annuities. They have made substantial progress, and expect to share some results at the September meeting.
10. **Actuarial Standards of Practice: Important:** The Actuarial Standards Board has set up two task forces to work on standards associated with the PBA approach. The first has developed a discussion draft on producing PBA reserves. The second is addressing the required peer review. As the regulations and guidelines needed to make PBA a reality progress toward adoption, this work will move into developing Exposure Drafts.
11. **Communications/Input from Industry: Important:** It is important that all the public is aware of issues, and have an opportunity for input. At the September meeting, there will be a review of such Academy sponsored opportunities, which include: the Academy website, an all day seminar on September 17th, and the Quarterly Webcast September 28th.