
American Academy of Actuaries
Annual Meeting and Public Policy Forum
2016
November 3-4, 2016 ★ Capital Hilton Washington, D.C.
American Academy of Actuaries
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NAIC Activity on Longevity Risk

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Topics to Be Covered

- NAIC 2016 Focus on Retirement Security
  - Education, Consumer Protection and Innovation
- NAIC's Longevity Risk Subgroup
- Longevity Considerations in Reserves and Capital
- Potential Changes Under Consideration by the Longevity Risk Subgroup

NAIC Focus on Retirement Security

- NAIC President John Huff made addressing retirement security a priority during his tenure to ensure people are ready to handle a wide array of issues related to their retirement.
- The NAIC's Retirement Security Initiative includes a three-pronged strategy: **education**, **consumer protection** and **innovation**.

NAIC Focus on Retirement Security

- This approach allows regulators to identify practical regulatory or policy issues that are in need of review, as well as highlight barriers to innovation, product delivery and compliance.
- Consumer outreach will bring into focus areas in need of improved understanding and access.
- Regulatory functions coordinated through the NAIC will continue to monitor for best practices regarding suitability, fair treatment and compliance.

Education

- The Retirement Security Initiative includes a partnership with celebrity spokesperson Rita Moreno. Her public service announcements are available in both English and Spanish and focus on the importance of planning early and understanding your financial picture as you grow older.
- Consumers currently seeking misplaced life and annuity contracts can use the National Life Insurance Policy Locator Service on the NAIC website, which is designed to make finding lost life policies and annuity contracts even easier by leveraging technology powered by the NAIC.

Education

- Also on the NAIC website is a link to a new microsite that pulls together retirement security consumer outreach into one easy-to-use online resource:

  http://www.insureuonline.org/insureu_retirement_security_resources.htm

- The site has consumer information on annuities, special considerations for multi-generational households, education on insurance needs for family members caring for an aging parent and information on long-term care and Medigap policies.

Consumer Protection

- NAIC committees are reviewing and updating model acts and regulations, and pushing for adoption in additional states. Many of these models focus on annuities, from suitability and disclosure to senior specific designations and certifications. Updates to these models and ultimately adoption into state laws will better protect individuals as they reach retirement age.
- The Life Actuarial Task Force and the Life Risk-Based Capital Working Group are looking at whether longevity risk is appropriately addressed in reserves and capital requirements to ensure that insurance company solvency is adequately protected from the potential impacts of the increasing longevity of our population.

Innovation

- Commissioner Huff has indicated that there is no greater area of the insurance sector in need of innovation than with long-term care insurance. The NAIC has established a Long-Term Care Innovations Subgroup that is looking at ways to remove barriers to product offerings while ensuring consumers remain protected.
- The NAIC has adopted the model law request to revise the Standard Nonforfeiture Law for Individual Deferred Annuities to exclude contingent deferred annuities (CDAs), which, due to their structure, cannot comply with the terms of the model. There may be future work on a nonforfeiture requirement for CDAs.

Longevity Risk Subgroup

- The Life Risk-Based Capital Working Group established the Longevity Risk Subgroup to look at issues regarding longevity risk and the fact that it is not currently reflected in the Life RBC Calculation.
- After some initial work by the Longevity Risk Subgroup, the LRBCWG determined that the best course of action was to address both reserves and capital and the working group was formally made a joint subgroup of the LRBCWG and LATF with the following charge:

Provide recommendations for recognizing longevity risk in statutory reserves and/or RBC, as appropriate.—Important

Review Summary - Priority Order & Calibration Method

Risk	Product*	RBC Charge for Longevity Risk	Longevity Risk in Formula Reserve	Subgroup's Priority	Calibration Technique
High	**Immediate Annuity**	No	Yes, since 2015	1	A
High	**Deferred Income Annuity**	No	Yes, since 2015	1	A
High	**Structured Settlement Annuity and Substandard Annuity**	No	Yes, since 2015	1	A
High	**Pension Buyout**	No	Yes, since 2015	1	A
High	**Longevity Swap**	No	NA	1	A
High	**Contingent Deferred Annuity**	Yes (C-3)	Yes	2	B
Low	**Variable Deferred Annuity**	Yes (C-3)	Yes	2	B
Low	**Variable Annuity with Death Benefit (GMDB)**	Yes (C-3)	Yes	2	B
Med	**Indexed Deferred Annuity with Living Benefit (GLWB)**	No	Yes, since 2015	3	B
Med	**Supplemental Agreement under Deferred Annuity or Life Insurance**	No	Yes, since 2015	3	B
Low	**Fixed Deferred Annuity (FDA)**	No	Yes, since 2015	3	B
Low	**Indexed Deferred Annuity**	No	Yes, since 2015	3	B
Low	**Lapse supported life Insurance**	No	NA	3	TBD

Actuarial Response to Longevity Issues

- The Academy established a Longevity Risk Task Force that is working on a conceptual framework for incorporating longevity risk in reserves or capital.
- The Society of Actuaries is working on some longevity-related research projects to look at the components of historical mortality improvement and analysis of historical U.S. population mortality improvement trends since 1950.
- All of this work will be used to drive the work of the NAIC's Longevity Risk Subgroup.

Longevity Risk Considerations

- The risk insurer's obligations increase due to increases in life expectancy
  - Mortality improvements have been sizable - 1% per year reduction in all-cause mortality between 1969 and 2013.
- Longevity risk was intentionally excluded from initial C-2 factors
  - Assumed to be immaterial (due to products and interest rates)
  - Slow emergence
  - Could be managed through reserves
- Continuing with a zero charge may not be prudent
  - Increase in the products marketed with material longevity risk
    - PRTs, income annuities, deferred annuities, LTC, GLIBs, CDAs, etc.
  - Other jurisdictions charge for longevity risk (e.g., UK)

Reporting Options: RBC and/or Reserves

Three Options: 1) RBC, 2) Reserves, or 3) both RBC and Reserves

- Unlike mortality and credit risk, longevity risk shows up slowly (in the form of small incremental payments)
  - PV of all the future extra payments will add up
  - Long exposure period may justify accounting for the risk through reserves (instead of RBC)
  - Mortality assumptions in reserves would have to be modified to cover the severe scenario
- If charged via reserves
  - Periodically prescribe the *improvement* assumption covering "severe" mortality improvements
- Combination of reserves and RBC for selected products (e.g., longevity wrappers, deferred income annuities, CDAs)

Considerations in Reflecting Longevity Risk

- Partial list of products to consider
  - All Income annuities Settlement options
  - Optional income benefits (e.g., GLIBs, GLWBs)
  - Longevity wrappers (e.g., CDAs, reinsurance)
  - LTC and other disability income products
- Magnitude of adjustments for margins in existing valuation mortality/morbidity tables
- Diversification benefits (i.e., longevity "hedge") achieved with life insurance
- Assumptions and methodology
  - Longevity improvement shock (both level and trend)
  - Long term interest rate

Examples of Other Jurisdictions

- Solvency II
  - BEL vs. BEL after 20% one-time shock to mortality
  - May be punitive at older ages and insufficient at the younger ages (since long term trends are ignored)
  - Hits existing business, but has a grade in period
  - Companies can get their internal models approved (likely difficult to do)
- Many jurisdictions charge for longevity (e.g., Canada, Chile)
  - Jurisdictional differences create arbitrage opportunities
- Some provide credit for longevity risk reduction/protection offered by life insurance

Diversification Benefits of Life Insurance

- Maximum hedge value achieved if
  - Same individual purchases both life annuity and single premium whole life insurance at the same time
  - Rarely achievable
- Important factors that lower the value of the hedge
  - Individuals buy different products at different ages
    - Life insurance buyers tend to be younger (& rarely buy SPWL)
    - Annuity buyers tend to be older
  - Life insurance policies lapse, income annuities do not
  - 1 year term has far less hedge value than, say, whole life (see appendix)
  - Differences in policyholder behavior (i.e., mortality disintermediation)
  - Product participation features (e.g., life insurance may be par, annuities may be non-par)

BIPARTISAN POLICY CENTER

Commission on Retirement Security and Personal Savings

Sylvester J. Schieber,
Member of the Commission on Retirement Security
and Personal Savings

4 November 2016

Full Recommendations Available at:
bipartisanpolicy.org/retirement-security

ABOUT THE BIPARTISAN POLICY CENTER

- Founded in 2007 by former Senate Majority Leaders George Mitchell, Howard Baker, Tom Daschle, and Bob Dole
  - A non-profit organization that drives principled solutions through rigorous analysis, reasoned negotiation and respectful dialogue. With projects in multiple issue areas,
  - The Bipartisan Policy Center (BPC) combines politically-balanced policymaking with strong, proactive advocacy and outreach.

COMMISSION BACKGROUND

- Launched in 2014
- Co-chaired by former Sen. Kent Conrad and James B. Lockhart III
- 19 commissioners from across the political spectrum, including former government officials, business leaders, and policy experts
- Formed to examine the U.S. retirement system and offer public policy recommendations that would improve retirement security

SIX CHALLENGES FOR RETIREMENT SECURITY AND PERSONAL SAVINGS

- Expand access to workplace retirement savings plans
- Reduce premature raiding of retirement accounts
- Improve insurance against longevity risk
- Make better use of home equity assets
- Make workers more effective savers
- Modernize Social Security and stabilize its financial viabiliy

IMPROVE ACCESS TO WORKPLACE RETIREMENT SAVINGS PLANS

- Create new **Retirement Security Plans** for smaller businesses with fewer than 500 employees, enabling multiple employers – even from different industries – to band together to offer their workers low-cost, well-designed savings options
  - Plans would have to be certified and thus, employers would be relieved of fiduciary responsibility for choosing a plan
  - All workers age 21 and with three months of service automatically covered
  - Free employers of plan administration beyond offering annual open enrollment and automatic payroll deductions
  - Accepting a safe harbor plan design would eliminate need for top-heavy and discrimination testing at the single employer level

IMPROVE ACCESS TO WORKPLACE RETIREMENT SAVINGS PLANS

- Create new **Retirement Security Plans** for smaller businesses
- Introduce a **nationwide minimum-coverage standard** from 2020 and beyond for businesses with more than 50 employees and meet one of three conditions:
  - Offer a fully qualified ERISA DB or DC retirement plan
  - Automatically enroll employees in a Retirement Security Plan
  - Automatically enroll employees in an enhanced MyRA

IMPROVE ACCESS TO WORKPLACE RETIREMENT SAVINGS PLANS

- Create new **Retirement Security Plans** for smaller businesses
- Introduce a **nationwide minimum-coverage standard** for businesses with more than 50 employees
- Establish a more-flexible safe harbor for employers that **automatically enroll** eligible new and existing employees in a plan that follows certain guidelines
  - Recognize that small employers might not be able to meet full save harbor requirements all at once and allow them to phase in with contribution limit scaling to encourage getting there
  - Matching contribution of 3 percent of pay or 2 percent non-elective contribution gives employee full 402(g) limit of $18,000 with catch up
  - No employer contribution ➔ 402(g) is $7,200 + $2,400 catch up
  - Matching contribution of 1% ➔ 402(g) is $10,800 + $3,600
  - Matching contribution of 2% ➔ 402(g) is $14,400 + $4,800

IMPROVE ACCESS TO WORKPLACE RETIREMENT SAVINGS PLANS

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- Introduce a **nationwide minimum-coverage standard** for businesses with more than 50 employees
- Establish a more-flexible safe harbor for employers that **automatically enroll** eligible new and existing employees in a plan that follows certain guidelines
- Improve **myRA** by allowing direct payroll deductions and employer contributions
- Create a new, refundable **Starter Saver's Match** of up to $500 for workers aged 18-35, to be directly deposited in retirement accounts
- Create a **Retirement Clearinghouse** to help savers consolidate savings spread across multiple accounts

FACILITATE LIFETIME-INCOME OPTIONS TO MAKE SAVINGS LAST IN RETIREMENT

- Encourage plan sponsors to integrate easy-to-use lifetime-income features (e.g., monthly guaranteed payments designed to last throughout retirement)

- Enable more plans to offer automatic installment purchases (i.e., laddering) of guaranteed lifetime-income products

- Provide enhanced safe harbors for plans which require participants to make an “active choice” for how to draw down their savings (i.e., lump sum, incrementally over time, etc.) or provide an option for automated annuitization of savings

FACILITATE THE USE OF HOME EQUITY FOR RETIREMENT CONSUMPTION

- Discourage use of home equity for pre-retirement consumption by eliminating tax deductibility of interest on mortgages on second homes or those that reduce equity in primary residences
- Establish a low-dollar reverse-mortgage pool for retired homeowners tapping a limited portion of their equity—say 30 percent or less—in their homes

- Benefit structure issues
  - System has always attempted to reward added work and contributions but to support basic adequacy
  - Low earners more dependent on Social Security than high earners
    - Viability of policies expecting low earners to save more will likely be ineffective
    - Even added saving for some cannot meet basic adequacy goals
  - Elements of benefit package adopted decades ago need adjustment to meet contemporary needs
- Financing issues
  - System is underfinanced to support benefits specified in current law
  - Options for rebalancing include raising taxes or cutting benefits each raising inter and intra-generational issues

COMMISSION PACKAGE GREATLY INCREASES BENEFITS FOR LOWER EARNERS

- Increase the progressivity of the benefit formula
  - Four PIA factors instead of three
  - Bottom factor is 95 percent and top is 5 percent
- Change application of benefit formula to reward longer careers
  - Apply the formula to each year of earnings
  - Sum highest 40 years of benefits
  - Divide by 37 to derive lifetime PIA
- Creates a new “basic minimum benefit” for lower-earning beneficiaries and bottom quintile would see benefits increased 66 percent relative to what is payable and 34 percent relative to what is payable
- Cap the spousal benefit at 75^{th} percentile of PIA distribution
- Introduce a 75 percent J&S benefit

OTHER SOCIAL SECURITY CHANGE PROPOSALS

- Index retirement age by one month for every two years starting in 2022
  - Full retirement age would reach age 69 in 2072
  - The maximum benefit age would be 72 at that time
- Index benefits by the chained CPI
- Raise the payroll tax cap
  - From $118,500 in 2016 to $195,000 in 2020
  - Indexing it by wage growth plus 0.5 percent beyond 2020
- Increase the payroll tax rate by 0.05 percentage points on employers and employees each year for 10 years—a total combined increase of 1 percent of covered pay
- Reinstate benefits for survivor children up to age 22 if they are full-time students

SUMMARY

- Greater access to savings plans and limiting leakages would most benefit the middle class
- Social Security reforms would secure benefits for all, enhance retirement security most for those at lower income levels and reduce poverty
- Greater lifetime-income options and take-up would reduce risks facing the elderly especially those long retirement lives, especially widows
- Greater access to and use of home equity would increase income for many elderly while allowing them to age in their preferred setting
- Enhanced financial awareness and abilities would increase the effectiveness of all the components of the package

- Unaddressed is remaining challenge in long LTC episodes