Life Insurance

L1a-2001 Preferred Tables for any 2001 Product

Summary of Request: The NAIC adopted the 2001 CSO Preferred Mortality tables for contracts issued on or after January 1, 2007 in Model Regulation 815. These Preferred Mortality Tables are allowed to be used to value the minimum standards for certain life insurance products instead of the original 2001 CSO Mortality Table under certain conditions specified in the regulation. These new CSO tables split the 2001 CSO mortality table into super preferred, preferred and residual standard classes with different mortality assumptions for each class. The ACLI request asks the regulators to allow insurers to utilize the 2001 CSO Preferred Mortality tables for contracts based on the 2001 CSO Mortality Table and issued prior to the January 1, 2007 effective date of the regulation.

WG Conclusion: Yes, this request can be provided, with some conditions:

- Why? Reserves for certain policies issued on a preferred basis may be overly conservative. The reserves calculated under the 2001 CSO preferred mortality tables are adequate (assuming appropriate use of the tables) and this use is already in place for policies issued on or after January 1, 2007. The required actuarial certification and experience reporting requirements should provide comfort as to the adequacy of the reserves.
- Conditions:
  - It should be noted that included in NAIC Model Regulation 815 section 5C are requirements for an insurer to utilize the 2001 preferred tables. This includes statistical experience data reporting requirements to the Commissioner which must be in a form acceptable to the Commissioner.
  - Note some companies may already be addressing the overly conservative reserves through a questionable reinsurance accounting practice. It is recommended that Commissioners consider requiring companies to demonstrate that they have not used such reinsurance accounting practices before allowing the company to utilize these tables for policies issued prior to January 1, 2007. Options for states to use in addressing this issue are set forth in Section 5D of the draft modifications to NAIC Model Regulation 815.

Potential Implementation:

- The LHATF has drafted a modified NAIC Model Regulation 815 including proposed changes to Section 4 which would allow states to authorize companies to utilize these preferred tables with a date earlier than January 1, 2007.

L1b-Make Section 8C of Actuarial Guideline 38 Retroactive to July 1, 2005

Summary of Request: Certain policy forms were designed to provide guaranteed benefits for the same required premiums as more traditional policy forms, but for which comparable reserves were not being established. To address this reserving discrepancy and properly value those relatively new policy forms, the NAIC adopted Regulation Triple-X in 1999 and Actuarial Guideline 38 in 2004. AG 38 was amended in 2005 to add a Section 8B to close a loophole that resulted in lower reserves for certain policy designs. Due to a sunset date, the AG was once again amended in 2006 by the addition of Section 8C based upon a CEO compromise. Section 8B applies to policies issued on or after July 1, 2005, and before January 1, 2007 and to policies issued on or after January 1, 2011; while Section 8C applies to the policies issued on or after January 1, 2007 and before January 1, 2011.

WG Conclusion: No, this request cannot be provided:

- Why not? There is no convincing evidence that reserves in the aggregate for these types of policies are redundant. Furthermore, the technical regulators are not convinced that the calculation prescribed in Section 8C of AG 38, which includes a lapse assumption that may not be conservative, will produce adequate reserves.

Potential Implementation:

- N/A

L1c-Clarify that Original Mortality Tables May be Used for Calculating Segments When Using the Preferred Structure Tables of the 2001 CSO

Summary of Request and Why?: Item 1c is a clarification of the Regulation Triple-X calculations to prevent the technical requirements of the calculation from taking away the reserve relief envisioned by Item 1a or Item 1b.

WG Conclusion: Yes, this request can be provided if Item 1a is provided.

Potential Implementation:

- The clarification of the segment calculation in the Triple-X regulation would be accomplished via a new actuarial guideline "interpreting" the calculation as described in this Item 1.c. A draft of this new AG has been completed by the LHATF

L2-Eliminate Constraints in Regulation Triple-X for the Calculation of X Factors

Summary of Request: Future benefits and future premium are determined using the CSO Mortality Tables. The difference between actual premiums and the anticipated premiums determined using the CSO Mortality Tables is set up as a deficiency reserve to fund reserves when actual premiums are lower. In the late 90's, the effect of this difference was significant, but since future mortality was unlikely to be at CSO levels, the concept of X Factors was developed. An X Factor is an experience factor that allows companies to reflect their actual anticipated mortality experience in developing the anticipated valuation premiums while still maintaining regulatory conservatism. The X factor is restricted to be no less than 20% and nondecreasing, and this request asks regulators to remove these restrictions.

WG Conclusion: Yes, an alternative proposal can be supported; with some conditions:

- Why? The Working Group believes that deficiency reserves are redundant, as the role of deficiency reserve has been supplanted by Asset Adequacy Analysis. The ACLI proposal does not suggest eliminating all deficiency reserves but rather eliminates the constraints on the X factors used in determining the deficiency reserves. Therefore regulatory objectives are still met.
- Conditions:
    - With the adoption of this change, the Working Group supports that the appointed actuary should make a statement in the actuarial opinion. This statement should discuss the X factor development process and the resulting changes in X factors consistent with the current requirements within the actuarial opinion model regulation as to the impact of the insufficiency of assets to support the payment of benefits and expenses and the establishment of statutory reserves.
    - The Working Group believes the resulting reduction in deficiency reserves should be reported as a change in valuation method and reported in Exhibit 5A, thus reflecting a release into surplus rather than an increment to the operating statement.

Potential Implementation:

- The LHATF has drafted a modified NAIC Model Regulation 830 with proposed changes to Section 5 which would eliminate the constraints for X factors in Regulation Triple-X.

L3-Facilitate Commissioners Discretion for Allowable Collateral for Reinsurance

Summary of Request: Item 3 is actually several requests regarding: reinsurance collateral forms; lines of credit (LOCs) and funds issued by the Federal Reserve or by U.S. banks and confirmed by the Federal Reserve; LOCs issued by non-bank U.S. institutions; expanding the interpretation of the phrase "any other form of security acceptable to the commissioner"; and establishing criteria for special purpose vehicles (SPVs) as accredited reinsurers.

WG Conclusion: Yes to some and No to others:

- The Model Credit for Reinsurance Law (Model Law) currently grants Commissioners authority under Section 3 to allow "any other form of security acceptable to the commissioner." This would include authority to accept LOCs issued or confirmed by the Federal Reserve, although the Working Group notes that the Federal Reserve does not currently perform either of these services. It is the opinion of the Working Group that it would not be consistent with regulatory objectives to accept and LOC that does not meet the requirements within Section 4 of the Model Law as a "qualified U.S. financial institution." [One of the Section 4 requirements is that the entity be supervised, regulated and examined by federal or state authorities having regulatory authority over banks and trust companies.] If an entity meets these requirements but has not applied to the NAIC Securities Valuation Office (SVO) for review, the Working Group believes that such "unlisted" entities should submit applications to the SVO to be considered for the NAIC List of Banks. Some jurisdictions will accept an LOC from a noninsurance U.S. parent, however, the Working Group notes that generally such an arrangement is required to include an LOC issued by a "qualified U.S. financial institution." The Working Group does not believe it is necessary to issue guidance recommending that such an agreement be accepted, as the availability of bank LOCs is one of the primary concerns expressed by the ACLI.
- The Working Group does not believe it would be consistent with regulatory objectives to expand the Accredited Reinsurer status to SPVs, nor does the Working Group believe this type of expansion would fall within a commissioner's authority under existing law and regulation.

Potential Implementation:

- The Reinsurance Task Force has drafted a guidance memo for commissioners regarding these issues as well as a model bulletin commissioners could consider using for public notice purposes.

Variable Annuities

VA1-Eliminate Stand-alone Asset Adequacy Analysis Required by AG 39

Summary of Request: For variable annuities with guaranteed living benefit riders (VAGLB), AG 39 requires a stand-alone asset adequacy analysis reflecting only benefits, expenses, and charges that are associated with the VAGLB riders (i.e., benefits, expenses and charges associated with the base contract or guaranteed minimum death benefit are excluded). AG 34 requires a stand-alone asset adequacy analysis reflecting all benefits, expenses and charges associated with the variable annuity contract. This request asks the regulators to remove the requirement of AG39's stand-alone asset adequacy analysis.

WG Conclusion: Yes, this request can be provided, with some conditions:

- Why? The Working Group notes that during 3rd quarter 2008, Actuarial Guideline VACARVM was adopted by LHATF and the NAIC following a great deal of compromise by all parties, with an effective date of year-end 2009. VACARVM incorporates two aspects key to this issue: (1) it calculates the reserve recognizing all cash flows (similar to AG 34) and (2) it contains constraints on assumptions and economic scenarios (not contained in AG 34).
- Conditions:
    - The request can be granted as long as the resulting asset adequacy testing performed under AG 34 is accomplished using these types of assumptions and constraints (see conditions).
    - The Working Group agreed that clarifications could be made to the RBC C3 Phase II Instructions for consistency with the changes being made in AG 39.

Potential Implementation:

- The LHATF has drafted a modified AG 39 including proposed changes to Section 3C and a new Section 3D which permit an alternative to the stand alone asset adequacy analysis for variable annuities with guaranteed living benefits. Specifically, the actuary may incorporate this analysis into the analysis required by AG 34. The proposed amendments clarify the scope of the asset adequacy analysis requirement and note the blocks of business to which it should be applied. They also provide a guide to the investment volatility to be tested and guidance on policyholder behavior assumptions to be used because AG 34 is silent on those factors. Both note that AG VACARVM may be used as a guide for assumptions, as well as RBC C3 Phase II. Finally, guidance is provided on topics to be included in the Actuarial Memorandum supporting the company's annual statement of actuarial opinion. The LHATF is also drafting an amended actuarial guideline including modified language relative to the appropriate reporting of changes in reserves.
- The LRBC WG has drafted modified RBC instructions for the relevant section of LR025 which can be posted on the NAIC website.

VA2-Waive the Standard Scenario as the Floor in the C-3 Phase II Calculation for the 2008 and 2009 LRBC Filings

Summary of Request: C-3 is the Interest Rate Risk component of the Life Risk-Based Capital (LRBC) formula. For the 2005 LRBC filings, C-3 Phase II instructions were included for variable annuities and similar products involving the use of many interest rate scenarios in the stochastic calculation which produces a total asset requirement (TAR). The resulting RBC amount is the excess of TAR over the reserve, and the Standard Scenario is the floor for the TAR established by regulators as a conservative precaution. This request asks that the Standard Scenario floor be removed from the TAR calculation in C-3 Phase II.

WG Conclusion: No, this request cannot be provided:

- Why not? The Capital Adequacy Task Force is reviewing the C-3 Phase II results. If the future results indicate the Standard Scenario floor is no longer necessary, then a recommendation to that effect will be provided by the Subgroup created to perform this review work. Results to date are mixed with respect to the Standard Scenario. Thus with the information available today, the Working Group is unable to definitively state that removing the Standard Scenario floor in C-3 Phase II would not compromise regulatory objectives.
- The Working Group also noted that the C-3 Phase II instructions allow for a smoothing option with domestic commissioner approval. This allows companies to use 40% of last year's TAR and 60% of the current year TAR rather than 100% of the current year TAR. This provision already allows some relief for companies with TAR calculations that increase this year due to the current credit crisis.

Potential Implementation:

- N/A

Investment

I1-Temporarily Fix the Mortgage Experience Adjustment Factor (MEAF) Calculation for LRBC

Summary of Request: The MEAF calculation includes the ratio of individual insurer commercial mortgage default experience to the industry average commercial mortgage default experience, with a cap of 350% and a floor of 50% on the ratio. These ratios are calculated using 8 quarter averages with a quarter lag; thus the 2008 RBC formula will utilize the eight quarters from 3rd Quarter 2006 to 3rd Quarter 2008. This request asks that a temporary floor be set for the industry average commercial default experience value.

WG Conclusion: No, this request cannot be provided:

- Why not? The Working Group notes that the LRBC WG has agreed to consider a permanent replacement of the MEAF calculation. However, the LRBC WG rejected the I1 request when it was submitted to that working group earlier in 2008, as there were concerns about the impact. The LRBC WG suggested some alternatives for a short-term solution to the ACLI, which was evaluating those alternatives and expected to return a revised proposal to the LRBC WG. It is estimated that the proposed floor would reduce the 2008 commercial mortgage default experience value by almost half of the 2007 value (a reduction of approximately $4 billion from the 2007 amount of $8.6 billion). No analysis has been provided to support the reduced aggregate RBC amount and particularly given the recent increase in commercial mortgage defaults and press reports indicating future problems with commercial mortgages. No change is supported since this change may be compromising regulatory objectives.

Potential Implementation:

- N/A

Accounting

A1-Follow GAAP rules for Deferred Tax Assets (DTAs)

Summary of Request: Actually, the request is split between an immediate consideration to increase the statutory admissibility limit on DTAs and a going forward project of considering following GAAP rules for DTAs instead of the current statutory rules.

DTAs represent amounts that the insurance entity may be able to use to offset future tax liabilities in the event the insurer earns a profit for that future period. Statutory accounting places conservative limitations on the amount of deferred tax assets that can be admitted. One of the DTA calculation components accomplishes a conservative limitation by restricting the realization period for the DTA to 1 year and capping this DTA component amount at 10% of adjusted capital and surplus. GAAP, on the other hand, allows full recognition of the entire deferred tax asset, but sets up a valuation allowance (or reserve) for any DTA that has a likelihood of 50% or better of not being realized. The specific ACLI suggested action is to modify one of the DTA calculation components by expanding the realization period from 1 year to 5 years and expanding the cap of this DTA component from 10% of adjusted capital and surplus to 25%.

WG Conclusion: Yes, an alternative proposal can be provided, with a condition:

- Why? The Working Group believes that some modifications to *SSAP No. 10—Income Taxes* (SSAP No. 10) can be made without compromising regulatory objectives. Discussion included the fact that given the significantly undervalued nature of many investments held by insurers, an increase in the DTA realization period would seem reasonable. The modification included in this recommendation is to increase the previously referenced DTA component by expanding the realization period from 1 year to 3 years and expanding the cap of this DTA component from 10% of adjusted capital and surplus to 15%.
  It should be noted however that some members of the Working Group did not agree with making any modifications to this accounting statement and reminded the members that the SAPWG indicated that no change should occur since DTAs are not available to pay claims if a company is liquidated (though the SAPWG did construct the alternate language included in this recommendation as a preference to any action on the ACLI original request of 5 years/25%).
- Condition:
  - The Working Group believes this revision should be revisited after the 2009 reporting period to determine if the limitation remains appropriate. It should also be noted that the Statutory Accounting Principles Working Group (SAPWG) intends to discuss the proposed idea of considering the GAAP treatment of DTAs in 2009, so the ACLI original request will still have an opportunity for consideration in the future.

Potential Implementation:

- A modified SSAP No. 10 has been drafted, including changes to: 1) increase the realization period in paragraph 10.b.i. from 1 to 3 years; and 2) increase the percentage limitation in paragraph 10.b.ii from 10% to no more than 15%. Other conforming changes may need to be made to the Question and Answer section of SSAP No. 10 but can be made by the Statutory Accounting Principles Working Group after the adoption of the changes to SSAP No. 10.