

Joint Working Group of the Life Insurance and Annuities (A) Committee and Financial Condition (E) Committee

Introduction

The Joint Working Group of the Life Insurance and Annuities (A) Committee and the Financial Condition (E) Committee was created to address the issues surrounding Actuarial Guideline XXXVIII (AG 38) and statutory reserve requirements for insurers offering universal life with secondary guarantee (ULSG) and Term UL products. The following charge was given to the Joint Working Group by the Executive Committee:

The joint working group shall work expeditiously to determine whether it is prudent and necessary to develop interim guidelines and/or tools to be utilized by regulators in evaluating reserves for ULSG and Term UL products and, if so, to promptly develop such interim guidelines and/or tools. As part of this effort, the working group shall make recommendations regarding whether these interim guidelines and/or tools should be applied to in force and/or prospective ULSG and Term UL products until such time as the final Valuation Manual is adopted. The working group shall use as guidance the work completed by the Life Actuarial Task Force with respect to this issue. Finally, the working group may engage resources as necessary to assist with analysis and preparation of necessary guidelines and/or regulatory tools.

Included below is a draft Framework that has been developed by the Joint Working Group covering In-Force Business and Prospective Business. Issues to be Addressed and the anticipated Sequence of Key Decisions are outlined in appendices attached to this Framework.

Draft Framework

I. In-Force Business:

1. Policies issued on or before a specified date would be treated as closed blocks of business.
2. Those closed blocks of in-force business would be evaluated by actuaries on a stand-alone basis. The evaluations would consist of asset adequacy analyses incorporating moderately adverse scenarios.
3. If it is determined the reserves are adequate on that basis, the company would not need to make an adjustment to its in-force reserves.
4. If it is determined the reserves are deficient on that basis, the company would need to increase reserves to the level determined pursuant to the asset adequacy analysis.
5. All states would rely on the conclusions reached pursuant to the actuarial evaluations. As such, the evaluations would lead to a unified regulatory decision regarding the adequacy of each company's in-force reserves and the manner and timing of any adjustments.

II. Prospective Business:

1. Policies issued on and after a specified date, but prior to the effective date of Principle-Based Reserving (PBR), would be reserved using a formulaic approach consistent with the Life Actuarial (A) Task Force's (LATF's) interpretation of AG 38 (as modified or clarified to address any questions regarding its requirements).
2. Policies issued on and after the effective date of PBR would be reserved using PBR methodology.

Process to Implement Framework

In implementing the Draft Framework, it is intended that a number of key decisions will still need to be made as the process is developed. For example, the NAIC will need to retain one or more independent, consulting actuaries to advise the Joint Working Group with respect to issues related to this Framework (actuaries will be selected with input from LATF/regulatory actuaries and interested parties). Issues to be Addressed and the anticipated Sequence of Key Decisions are outlined in appendices attached to this Framework. Implementing these decisions will be done through an open process in consultation with regulators and interested parties, with periodic reports to the parent committees.

Appendix I: Issues to be Addressed

I. In-Force Business

1. Clarify which products, companies and blocks of business are subject to the actuarial evaluations.
 - a. Should the evaluations cover all such products, whenever written, or only those written after certain specified dates (for example, dates tied to various changes in AG 38)?
 - b. Should there be a *de minimis* exception so that, for example, evaluations do not need to be performed if a particular company's reserves for these types of policies do not exceed a specified percentage of the company's surplus?
2. Determine which actuaries will perform the evaluations.
 - a. Should the evaluations be performed by regulatory actuaries? By independent (consulting) actuaries? Another option may be to allow each company to perform its own reserve calculations using prescribed assumptions/methodologies developed by the Joint Working Group (in consultation with regulatory actuaries and/or consulting actuaries) and subject to regulatory oversight and review.
 - b. If consulting actuaries are used, how should they be selected? (It will be important that the actuaries have appropriate credibility with both industry and the regulatory community so there is confidence in the conclusions reached.)
 - c. Should the Joint Working Group—in collaboration with LATF, other interested regulators and industry—develop a list of actuaries from which the domiciliary state would select?
 - d. If consulting actuaries are used, how many are needed to be able to perform the work in a timely manner?
3. Define the methodologies and/or assumptions to be used in connection with the actuarial evaluations. It is important that actuaries performing the evaluations (whether regulatory, consulting or company) consistently apply key assumptions. Flexibility may be needed, however, based on differing product types and other factors.
 - a. Should actuaries performing the evaluations (whether regulatory, consulting or company) use prescribed methodologies and assumptions? If the actuaries, instead, are given flexibility to apply judgment, how can the regulatory community be assured all evaluations are appropriately conservative and all companies are being treated consistently?
 - b. How do decisions in this area impact the need for or selection of consulting actuaries? For example, if key methodologies and/or assumptions are prescribed, the regulatory community may not have as much concern regarding which actuaries perform the work than if the actuaries are allowed to apply judgment (which could lead to the use of differing methodologies and assumptions).
 - c. Should a standardized report format be used to help ensure consistency?

- d. Is it possible to use in some way the asset adequacy analyses currently performed by companies pursuant to AG 38, or reserve evaluations performed as part of recent or ongoing examinations, to minimize duplicative work?
4. Select the cut-off date for policies subject to the actuarial evaluations.
 - a. Is it important to prevent a “gap” period between the cut-off date and the date on which the prospective requirement commences? If so, the two dates should be tied. For example, if the prospective requirement commences July 1, 2012, the “cut off” date would be June 30, 2012. (Note: It may be difficult to determine the appropriate prospective date until a final, formulaic approach is developed and a mechanism for addressing company questions is established).
5. Develop a process to address actuarial conclusions with respect to the adequacy of a company’s in-force reserves in order to achieve unified regulatory treatment regarding the manner and timing of any adjustments.
 - a. Who within the regulatory community should oversee the actuarial work performed and be responsible for making decisions regarding conclusions reached by the actuaries (including decisions regarding such matters as whether reserve deficiencies must be booked immediately or may be phased-in)?
 - b. Should the domiciliary regulator be the primary recipient of, and decision maker regarding, the actuarial evaluation report? For nationally significant companies, the actuarial evaluation reports might also be reviewed by the NAIC’s Financial Analysis Working Group (FAWG). The Joint Working Group might also remain involved in some manner.
 - c. Should a group of regulators be established relative to each company to serve as the primary recipient of, and decision maker regarding, the actuarial evaluation report? For example, the group of regulators might consist of the domiciliary regulator and the regulators of several other states in which the company writes substantial amounts of business. As another example, the group of regulators might be determined pursuant to the NAIC’s former association examination (zone) process.
6. Develop a timeframe as to when the actuarial evaluations are to be started and completed.
 - a. When can final decisions regarding such a timeframe be made? Decisions regarding how quickly the analyses should be completed will depend, in part, on the number of companies and the amount of business involved. The desired timing will also impact and/or be determined by the number of actuaries performing the analyses.
 - b. Should the Joint Working Group set a specified timeframe or target date as to when the actuarial work is to be completed—for example, within six months of the “cut off” date—or should the completion date be left open?
7. Define the frequency of the actuarial evaluations.

- a. Should the evaluations be one-time events (subject to follow-up work if the initial evaluations identify issues of concern) or should they be conducted annually or on some other recurring basis?
 - b. If the evaluations are to be recurring, would the process be the same for future evaluations as for the initial ones?
8. Determine whether there are any companies that (a) have written the specific types of products referred to in item 1-above, and (b) have historically reserved for those specific products using an approach consistent with the current LATF statement. If so, determine how or whether to apply the Framework to such companies and products.
- a. How should such determinations be made and implemented?
9. Determine how to document/implement the bifurcated Framework so it complies with the laws of the various states, including those states that use the LATF interpretation of AG 38 when construing their Standard Valuation Law.
- a. What steps are needed to give states comfort they have the legal authority to adopt (agree to) the Framework?
 - b. Are there provisions in the Standard Valuation Law—or in other laws, regulations, and/or guidance—that would allow ancillary states to rely on domiciliary states’ legal interpretation of AG 38 and/or the Standard Valuation Law so long as the ancillary states are confident that the reserves held by insurers are sufficient to cover those insurers’ policy obligations?

II. Prospective Business

1. Determine the effective date on which compliance with the prospective requirement commences.
 - a. How do you balance industry’s desire for sufficient lead-time to retool products and get them ready for market with the desire of others to reach a unified reserving approach as soon as possible?
 - b. Is it important to prevent a “gap” period between the date on which the prospective requirement commences and cut-off date for policies to be included in the closed blocks of in-force? If so, the two dates should be tied. For example, if the “cut off” date is June 30, 2012, the prospective requirement would commence July 1, 2012.
 - c. Can a mechanism to answer questions as to how to apply the prospective requirements to specific products (see below) be developed quickly enough to answer companies’ questions prior to the commencement date?
2. Develop a mechanism that leads to unified regulatory guidance in response to any questions that may arise as to how to apply the prospective requirements to specific products.
 - a. Who should companies ask if they have questions regarding how to apply the prospective requirements to specific products? Should LATF or some other body of regulatory actuaries provide guidance regarding these matters? If consulting actuaries perform the actuarial evaluations of the closed in-force blocks of

business, should those actuaries be involved in this process in some way? Should the Joint Working Group be used for this purpose?

- b. How should this mechanism be structured so unified regulatory guidance can be provided? The objective is to have all states accept the guidance given so companies are not challenged at a later date about their choice of reserving methodology.
 - c. Should this mechanism also serve as a forum in which companies may ask for adjustments to the reserving requirements to address concerns they might have regarding possible reserving redundancies (e.g., use of preferred mortality tables, lapse experience assumptions, X factors, etc.)?
 - d. If such adjustments are sought and granted, how can they be implemented in a way that preserves a level playing field among companies?
 - e. Should individual states, the NAIC and/or the Interstate Insurance Product Regulatory Commission help monitor the market by identifying new product designs that are submitted for approval and determining whether the companies have an appropriate understanding of the applicable reserving requirements?
3. Consider referring to the NAIC's PBR Working Group the question of whether companies should be allowed to apply PBR retroactively, once it becomes effective, so it covers policies issued on and after the prospective commencement date discussed in paragraph 1-above.
- a. Because PBR has not yet been adopted in any state, is it possible to modify the Standard Valuation Law so PBR applies retroactively to the date discussed in paragraph 1-above, once adopted? Would such retroactive application of PBR be appropriate in the broader context of the applicability of PBR?
 - b. Can retroactive application of PBR be accomplished in a way that does not result in negative tax treatment?
4. Determine how to document guidance to industry and regulators regarding these matters to minimize confusion and ambiguity as to what is required or expected.
- a. Is it possible to resolve the issues involved without formal changes to existing law or guidance?
 - b. If not, what is the most expeditious and least disruptive way such guidance could be documented?

Appendix II: Sequence of Key Decisions

In order to move forward with a resolution of the AG 38 issue, NAIC commissioners will be asked to consider and vote on a series of recommendations of the Joint Working Group. The issues and a proposed sequence of decision-making are set forth below. These recommendations are grouped-below into three separate phases based upon the order in which the key decisions should be made.

I. Phase 1 Decisions

1. Adopt Framework (i.e., bifurcated approach to In-Force and Prospective Business) in concept.
2. The NAIC will retain one or more independent, consulting actuaries to advise the Joint Working Group with respect to the issues identified in the Framework and Appendix I— Issues to be Addressed. Actuaries will be selected with input from LATF/regulatory actuaries and interested parties. Because independent, consulting actuaries may be deemed necessary for subsequent issues, a pool of consultants should be identified.

II. Phase 2 Decisions

3. Once the Framework is adopted in concept and the consulting actuaries have been selected, the Joint Working Group will develop and present recommendations to the NAIC with respect to the following issues in order to begin implementation of the Framework (Note: LATF/regulatory actuaries and interested parties will be able to provide input to and/or ask questions of consulting actuaries with respect to these issues):
 - a. Date on which the block of In-Force Business is considered closed and on which the Prospective Business requirements commence.
 - b. Policy decisions regarding the scope of products and companies covered by the actuarial evaluations; e.g., types of products, whether evaluations cover all such products (whenever written) or only those written after specified dates, etc.
 - c. Development of assumptions and methodologies to be used on the actuarial evaluations.
 - d. Finalization of formulaic approach to AG 38 for prospective business consistent with the LATF interpretation of AG 38 (as modified).
4. As work on the above-issues is proceeding, the Joint Working Group will develop and present recommendations regarding the following:
 - a. The group of actuaries (regulatory, industry and/or consulting actuaries) that will perform the actuarial evaluations, and the assumptions and methodologies to be used.
 - b. The target date for completion of the actuarial evaluations.
 - c. The frequency of the actuarial examinations; i.e., one-time (subject to re-examination if circumstances warrant) or ongoing.
 - d. Whether the “PBR retroactivity” question should be referred to the NAIC PBR Working Group.

- e. The mechanism for responding to specific questions from interested parties about particular products under the prospective requirements.

III. Phase 3 Decisions.

- 5. Finalize work to document/implement the bifurcated Framework so it complies with the laws of the various states.
 - a. Finalize legal research, if necessary, regarding the laws of various states and options those states have regarding compliance issues.
 - b. Determine whether modifications to portions of the Framework are appropriate to facilitate legal compliance.
 - c. Determine whether steps can be taken by domiciliary states to facilitate legal compliance in ancillary states.
- 6. The process to address actuarial conclusions with respect to the adequacy of a company's in-force reserves in order to achieve unified regulatory treatment regarding the manner and timing of any adjustments.
- 7. Final decisions to be made include:
 - a. Documentation of guidance provided under the Framework.
 - b. Treatment of companies currently reserving in accordance with LATF's interpretation of AG 38 that want to revise in-force reserves.