

## PROJECT HISTORY - 2009

### ACTUARIAL OPINION AND MEMORANDUM REGULATION (#822)

#### 1. Description of the Project, Issues Addressed, etc.

The project was to remove the restrictions on the mortality adjustment factors (X factors) in the deficiency reserve calculation required by the Valuation of Life Insurance Policies Model Regulation. Therefore, the Task Force, as part of the Regulatory Asset Adequacy Issues Summaries required of life insured companies each year, required the appointed actuary to make a statement as to the impact of the insufficiency of assets to support the payment of benefits and expenses and the establishment of statutory reserves during one or more interim periods. The definition of the Regulatory Asset Adequacy Issues Summary as defined in the Actuarial Opinion and Memorandum Regulation was modified to reflect this requirement.

#### 2. Name of Group Responsible for Drafting the Model and States Participating

The 2009 members of the Life and Health Actuarial Task Force are: Kansas (chair), South Carolina (Vice Chair), Alaska, Alabama, Arkansas, California, Connecticut, Florida, Hawaii, Minnesota, Missouri, Nebraska, New York, Ohio, Oklahoma, Texas and Utah.

#### 3. Project Authorized by What Charge and Date First Given to the Group

The initial charge was given to the Task Force in November 2008, by the Capital and Surplus Relief (EX) Working Group to consider the November 11, 2008, proposal from the American Council of Life Insurers. The proposal was rejected by the Executive Committee in January 2009. At the 2009 Commissioners Conference the Task Force was again charged with reviewing the proposal.

#### 4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

The initial drafts were provided by the American Council of Life Insurers. A subgroup of the Task Force made changes and made a recommendation to the Task Force. The Task Force made several modifications.

#### 5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The subgroup discussed the proposal at public conference calls on this topic on the following dates: March 27, 2009; March 31, 2009; April 7, 2009; April 14, 2009; April 21, 2009; and April 28, 2009. The Task Force held a public conference call on this topic on May 4, 2009. Notice of each of these conference calls was posted on the NAIC's home page on the Internet and e-mailed to approximately 300 interested parties. Drafts of the document were released for comment on December 23, 2008 and May 4, 2009. The Task Force voted to adopt the model regulation on June 3, 2009, without an additional 30-day exposure period. The vote was eleven in favor (Alabama, Alaska, Arkansas, California, Connecticut, Minnesota, Missouri, Nebraska, Oklahoma, South Carolina, and Texas), two abstaining (Florida and New York) and one not voting (Ohio).

#### 6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response)

#### 7. Any Other Important Information (e.g., amending an accreditation standard).

This model regulation is an accreditation standard.

## PROJECT HISTORY - 2001

### ACTUARIAL OPINION AND MEMORANDUM REGULATION (#822)

#### 1. What issues was the project intended to address?

This project addressed four primary questions: 1) Should small companies be exempt from performing an asset adequacy analysis; 2) What flexibility should be provided commissioners in accepting actuarial opinions based on foreign states' laws; and 3) Should additional information be required to be included in the actuarial memorandum; and 4) Should a confidential summary of the assumptions and results of the asset adequacy analysis be prepared and submitted to the commissioners?

#### 2. What states participated in drafting the model?

The following states are currently members of the Task Force: New Mexico (Chair), California (Vice-Chair), Arkansas, Connecticut, Florida, Illinois, Kansas, Michigan, Minnesota, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Texas, and Utah

#### 3. When was the charge given to the task force, and what was the nature of the charge?

The AOMR was adopted by the NAIC in 1991. A limited number of revisions to the model were made in the eighteen months subsequent to its adoption. Since that time, discussions have been ongoing relative to numerous aspects of the model. The primary aspects which have been addressed are identified in Item #1.

#### 4. What general procedure was followed in drafting the model? What efforts were made to assure that all interested parties were provided an opportunity to comment during the drafting process?

The efforts of the Task Force were closely coordinated with all industry interested parties. In addition to open sessions at the quarterly meetings of the NAIC, numerous conference calls were held over the last several years to discuss the various drafts of the revised model. Notice of those conference calls were posted on the NAIC's home page on the Internet and e-mailed to approximately 150 interested parties, including representatives of the American Council of Life Insurers, the National Alliance of Life Companies, and the National Fraternal Congress of America. Additionally, representatives of the American Academy of Actuaries and the Actuarial Standards Board provided significant input on this matter.

#### 5. What significant issues were raised during the drafting process, and how were those issues resolved?

##### a) Should small companies be exempt from performing an asset adequacy analysis?

All life insurers are required to file an actuarial opinion with their annual financial statement. In 1991, the NAIC adopted the AOMR which, in essence, established a two-tier system for these opinions. Companies whose admitted assets exceed \$500 million are required to conduct sufficient tests such that they can certify that their assets "make adequate provision" for their liabilities, i.e., their actuaries must perform an asset adequacy analysis. Under certain conditions, companies whose admitted assets fall below \$500 million are exempt from this requirement and need only certify that their reserves have been computed in accordance with the formulas specified in the law. (The larger companies must also meet this additional requirement.)

The two-tier system was adopted due to concerns over the expense that asset adequacy analyses would impose on smaller companies. The following excerpt is from the June 3, 1989, Report of the Special Advisory Committee on the Standard Valuation Law: "At the committee's Dec. 1, 1988, meeting, Kenneth Andre, president of Guarantee Reserve Life and then chairman-elect of the National Association of Life Companies, discussed the thrust of the committee's work from a small and medium company perspective. Mr. Andre urged the committee to keep in mind that analyses of the kind being discussed by the committee can represent a major challenge and expense impact for small and medium companies. He said that this should not, however, be interpreted to suggest that such companies would not generally support the goals of this approach to valuation."

The concern stated above continues to be expressed by industry representatives. This excerpt from a April 5, 2000, memo written by Scott Cipinko, Executive Director of the National Alliance of Life Companies ("NALC"), is representative of the fears which have been communicated to the Task Force:

The NALC remains opposed to additional testing for two reasons:

- 1) The cost of the testing is not justified by the “Benefit,” which is as yet unknown--what benefit will be received for the additional cost? and
- 2) What is the harm to be avoided by the additional testing?

Industry representatives also point out that the current version of the AOMR contains the following language: “the Commissioner may require any company otherwise exempt pursuant to this regulation to submit a statement of actuarial opinion and to prepare a memorandum in support thereof in accordance with Sections 8 and 9 of this regulation if, in the opinion of the Commissioner, an asset adequacy analysis is necessary with respect to the company.” They argue that this gives the commissioners all the authority they need to require asset adequacy testing for smaller companies without totally eliminating the exemptions.

Those comments notwithstanding, the Task Force is recommending removal of the exemptions, thereby requiring all companies to demonstrate the adequacy of their reserves. The Task Force is in agreement with the position expressed by the State Variations in Valuation Laws Task Force of the American Academy of Actuaries in its May 10, 1996, report. On page 4, the following recommendation is made:

AOM Model Regulation: Delete Sections 6 and 7 completely. The rationale is:

- Uniform Actuarial Opinions are important, both in terms of policyholder protection and the integrity of the statutory accounting system;
- There is no precedence in GAAP, Risk Based Capital requirements, etc. for different standards based on size;
- Formula reserves alone may not be sufficient;
- Foreign states are more likely to accept a domiciliary state’s AOM if the reserves are tested for adequacy.

The Task Force does recognize that the issue of expenses is a legitimate concern. During this project, the Task Force has received the assistance of the Actuarial Standards Board, which has developed revised standards of actuarial practice relative to this matter. The revised standards are currently being exposed and will be finalized later this year. They provide for the actuary to perform necessary testing based on the degree of risk inherent in the contracts sold. This ranges from very little (in some cases only intermittent testing is necessary) to cash flow modeling. This availability of a range of methods will allow each company to choose the one (or combination) which best fits its circumstances, thereby minimizing the expense each will incur in fulfilling this requirement.

**b) What flexibility should be provided commissioners in accepting actuarial opinions based on foreign states’ laws?**

Section 3A of the Standard Valuation Law requires the filing of an actuarial opinion stating that “reserves and related actuarial items...comply with applicable laws of this state. The commissioner shall define by regulation the specifics of this opinion and add any other items deemed to be necessary to its scope.” In implementing that provision, the current AOMR requires all companies to file an actuarial opinion that the reserves 1) meet the requirements of the law of the state of domicile and 2) are at least as great, in the aggregate, as required by the state in which the filing is made. Many industry representatives strongly object to the second provision. They argue that it is an unreasonable burden for them to monitor compliance of their reserves relative to the laws of every state in which they do business. They want this second provision eliminated, so that they only have to certify that they meet the requirements of their state of domicile.

On the other side, many regulators are strongly opposed to eliminating the “state of filing” provision. They argue that that this would amount to a usurpation of their right to impose the solvency standards they believe are best for companies (both domestic and foreign) that do business in their state. They also argue that, if this rule were to be implemented, companies domiciled in states with relatively weaker reserving laws would have an unfair advantage over other companies. (In response to that argument, critics of the current requirement maintain that the accreditation process assures that each state has appropriate reserving requirements.)

In an effort to reach a compromise, the Task Force is proposing amendments to the AOMR. The general standard will be maintained that reserves are subject to the laws of the state where the statement is filed, i.e., a State A domestic operating in State B will remain subject to State B’s laws relative to reserves. However, State B would then have three options that may be used in lieu of simply requiring the “state of filing” opinion. In essence, the

options permit a “state of domicile” opinion, but they require that certain financial standards be met or that financial information be provided so that State B can make an informed decision as to whether the domestic state’s reserve laws, as applied to this specific State A domestic, reasonably meet State B’s standards. If the State B is satisfied, then the “state of domicile” opinion would be deemed to meet its reserve requirements. If State B is not satisfied, or if the State A domestic simply decides to go ahead and submit a “state of filing” opinion, then it would submit an actuarial opinion that certifies, in the aggregate, its reserves comply with State B’s standards.

The American Council of Life Insurers is strongly opposed to these amendments as written. Following is an excerpt from a November 9, 2000 memo on behalf of the ACLI’s Actuarial Committee: “The ACLI’s Actuarial Committee has carefully reviewed the proposed AOMR revision, with particular attention to the proposals for an alternate option with respect to state of domicile opinions in Section 6F(1), and, while the Committee recognizes and appreciates the effort that went into attempting to solve the vexing problem of different requirements among the states, it concluded that the proposal should be withdrawn.” Essentially, their position is the proposed changes are cumbersome and would accomplish little towards simplifying the process.

Most of the Task Force takes a contrary view. They believe that if a significant number of states adopt these amendments, it will accomplish two things: 1) Provide relief for the companies from keeping abreast of reserve requirements in the adopting states, and 2) Preserve the principle of a state’s right to adopt the laws it feels are best suited to its circumstances.

**c) Should additional information be required to be included in the Actuarial Memorandum?**

The AOMR requires that “in accordance with Section 3 of the Standard Valuation Law, the appointed actuary shall prepare a memorandum to the company describing the analysis done in support of his or her opinion regarding the reserves under a Section 8 opinion.” Since the implementation of the AOMR, new products have emerged and new insights have been gained regarding the key aspects which ought to be documented in the memorandum. The proposed revisions to the AOMR include updated requirements for documentation of the various assumptions, economic scenarios, and product features incorporated into the asset adequacy analysis.

**d) Should a confidential summary of the assumptions and results of the asset adequacy analysis be prepared and submitted to the commissioners?**

Depending upon a particular company’s circumstances, the actuarial memorandum may be a voluminous and complex document. The proposed revisions to the AOMR include a requirement that a “Regulatory Asset Adequacy Issues Summary” be prepared which summarizes the major assumptions and economic scenarios embedded in the actuarial memorandum. It is hoped that inclusion of this confidential summary will increase the efficiency with which the actuarial opinion and memorandum are reviewed.

**6. What are the implications of this project for accreditation and codification?**

The accreditation standards require that “the NAIC’s Standard Valuation Law and Actuarial Opinion and Memorandum Regulation or substantially similar provisions shall be in place.” Appendix A-822 of the Accounting Practices and Procedures Manual includes substantial portions of the AOMR.