

A Regulator's Perspectives

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Discussion Points

- General State Insurance Department Facts
- Life Insurance/Annuities – Hot Topics
- Healthcare – Ongoing Issues



General State Insurance Department Facts

NAIC



NAIC

- NAIC – National Association of Insurance Commissioners , although not having any legal power, carries substantial weight in forming the basis for state regulation through:
 - Model Laws (e.g. SVL)
 - Actuarial Guidelines (40)



General State Insurance Department Facts

What Departments Do



What Departments Do

- State Insurances Departments Approve or Disapprove:
 - All Policy Forms & Marketing Materials
 - Rates
 - Rating Methodologies (Fair & Actuarially Sound)
- State Insurances Departments Review and Analyze:
 - Company Solvency and Persistency Issues



What Departments Do

- State Insurances Departments are revenue generators:
 - Nationally (2004), \$15.3 Billion
 - 86.6% from premium taxes
 - 0.3% from fines and penalties



Life Insurance/Annuities Hot Topics

A Principles-Based Approach



Highlights

- Company Measurement Tools
- Is a New Approach Necessary?
- A Principles-Based Approach
- Principles-Based Initiatives



Company Measurement Tools

- Valuation of Reserves

$$\text{Reserves} = \text{PV of Future Benefits less} \\ \text{PV of Future Premiums}$$

Note: Calculated using prescribed valuation interest rates and mortality.



Company Measurement Tools

- Risk-Based Capital
 - is an amount of capital based on an assessment of risks that an insurer should hold to protect insureds against adverse developments



Company Measurement Tools

- Risk-Based Capital
 - Asset Risk (C1 Risk)
 - Value of insurer's investment assets may decline
 - Pricing Risk (C2 Risk)
 - Uncertainty of future operating results (investment income, mortality, sales, lapses, etc.)



Company Measurement Tools

- Risk-Based Capital
 - Asset/Liability Matching Risk (C3 Risk)
 - Results from the likelihood that policy owner cash obligation may exceed current cash income from premiums and investments
 - Miscellaneous Risk (C4 Risk)
 - Could result from tax or regulatory changes



Is a New Approach Necessary?

- Important Factors prevalent in the current insurance industry:
 - Increased Complexity in Product Design
 - Products are being developed with a focus on guaranteed elements
 - Universal Life with no lapse or secondary guarantees
 - Annuities with guaranteed minimum withdrawal or income benefits
 - These new embedded risks require very sophisticated modeling techniques in order to understand and hedge them



Is a New Approach Necessary?

- Important Factors prevalent in the current insurance industry:
 - Advances in Risk Management Theory
 - Advances in Computer Processing
 - Advances in Actuarial Modeling Software



Is a New Approach Necessary?

- Important Factors prevalent in the current insurance industry:
 - The current environment for calculating reserves and risk-based capital is utilizes a rules-based approach, which:
 - Relies on a static formula, which may or may not capture all of the risks associated with the contract
 - Utilizes prescribed valuation assumptions that are the same across all companies, regardless of risk profile differences



Is a New Approach Necessary?

- This current “Rules-based” reserve system:
 - Can lead to overly conservative reserves for certain products that raises the costs, or limits the availability (because of the costs), of insurance to the consumer.
 - This can also lead to inadequate reserves for other products.



Is a New Approach Necessary?

- This current “Rules-based” reserve system:
 - 2001 CSO valuation mortality requirements are too high for some products
 - A survey found that more than 80% of participating companies were utilizing three or more non-tobacco underwriting classes; however, the 2001 CSO table only uses one non-tobacco underwriting class.
 - The management of overly conservative reserves produces a higher administrative expense to the consumer



Is a New Approach Necessary?

- Current Regulatory Issues:
 - Increased Regulations for Complex Products
 - Law & Regulations do not address all risks
 - As regulations increase, less state uniformity
 - Complex Regulations become convoluted
 - Statutory Law may inhibit Product Design



A Principle-Based Approach

- A Principles-Based Approach to Reserves:
 - Utilizes Risk Analysis and Risk Management techniques to quantify risk
 - Captures all identifiable material risks, benefits and guarantees of the contract or company
 - Permits the use of company-specific experience based on the availability of relevant experience and its degree of credibility



A Principle-Based Approach

- A Principles-Based Approach to Reserves:
 - “Right Sizes” reserves and capital
 - Requires more sophisticated tools
 - Requires a strong governance process



Principles-Based Initiatives

- New Actuarial Guidelines:
 - AG ABC
 - Projection of Guaranteed Nonforfeiture Benefits Under CARVM
 - AG DIS
 - Documentation and Disclosure Requirements under a PBR Model Regulation
 - AG MAR
 - Requirements for establishing Margins for Prudent Best Estimates



Principles-Based Initiatives

- New Actuarial Guidelines:
 - AG PBR
 - Valuation Assumptions for PBR



Principles-Based Initiatives

- Risk-Based Capital
 - C3 Phase I (implemented 12/31/2000)
 - Addresses interest rate risk for deferred and immediate annuities, structured settlements and guaranteed separate accounts
 - C3 Phase II (implemented 12/31/2005)
 - Addresses both interest rate risk and equity risk associated with variable annuities with guarantees



Principles-Based Initiatives

- Preferred Mortality Study
 - SOA/AAA Initiative is scheduled to be completed by 10/31/2006
 - Should produce either new mortality tables or revised 2001 CSO tables with the following underwriting classes:
 - Super Preferred Non-Smoker
 - Preferred Non-Smoker
 - Standard Non-Smoker
 - Preferred Smoker
 - Non-Standard Smoker



Life Insurance/Annuities Hot Topics

SERFF



SERFF

- SERFF stands for System for Electronic Rate and Form Filing; it is an NAIC software application that allows insurance companies to transmit filings electronically to state insurance departments. In Ohio, 50+% of the Life & Health filings are received via SERFF and 50% via paper.



Life Insurance/Annuities Hot Topics

Interstate Compact



Interstate Compact

- This NAIC initiative has the goal of modernizing insurance regulation by:
 - Reducing the review and approval time
 - Establishing a single point-of-filing for uniform product review
 - By appointing a state representative to a multi-state Interstate Insurance Product Regulation Commission, which would develop standards for the review of life insurance, annuities, disability income and long term care insurance products



Healthcare – Ongoing Issues

Industry Response to the Increasing
Cost of Healthcare



Industry Response to the Increasing Cost of Healthcare

- Leaner Benefit Design
- Reduced Provider Contract Amounts
- More Stringent Underwriting Criteria
- Disease Management Programs
 - Targets specific conditions such as CHF, Diabetes and asthma



Industry Response to the Increasing Cost of Healthcare

- Increased Cost Sharing
 - Consumer Driven Health Plans
 - HSA's – Health Savings Accounts - which were first developed in 2003; enables employees to put away money tax free into a personal care account for medical expenses that roll over year-to-year. HSA's are portable.



Industry Response to the Increasing Cost of Healthcare

– Consumer Driven Health Plans

- HRA's – Health Reimbursement Accounts – which were established many years prior to the establishment of the HSA; There are three main components: 1) an employer provided personal care account, 2) a deductible bridge 3) traditional health coverage. The HRA is not portable when an employees leaves the employer.
- Both HSA's and HRA's promote in the employee an incentive to wisely spend the money in the personal care account



Healthcare – Ongoing Issues

Medicare



What Is Medicare?

Is a federal health insurance program established in 1965, that provides coverage primarily to beneficiaries 65 and older. Eligible beneficiaries are covered, no matter the medical history or income. Currently there are over 41 million eligible beneficiaries covered. Experts have estimated that by 2030, there will be over 78 million eligible beneficiaries.



How Is Medicare Structured?

Part A - Hospital Insurance(HI) program

- Covers inpatient hospital, SNF, etc.
- Financed by HI Trust Fund which receives income from payroll taxes



How Is Medicare Structured?

Part B – Supplemental Medical Insurance (SMI) program

- Covers physicians services, lab, etc.
- Financed by SMI Trust Fund which receives income from beneficiary premium and general tax revenue



How Is Medicare Structured?

Part C – Medicare Advantage (formerly Medicare+Choice until 2003)

- Managed Care Plans that contract with Medicare provide Parts A and B to eligibles
- Financed by Medicare on a per member per month basis at the county level



How Is Medicare Structured?

Part D refers to the new Rx benefit for 2006

- Enacted as a result of the Medicare Modernization Act of 2003
- Financed by beneficiary premiums and general revenue



Beneficiary Plan Options

- Standard FFS Medicare
- Medicare Supplemental
- Medicare Advantage (Managed Care)



Questions?

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