NAIC Review of No-Lapse Guarantee Universal Life Reserves

On November 1, 2011, *The Wall Street Journal* (WSJ) published an article titled "Insurer's Reserves Examined." The article (see excerpts below) addressed regulatory discussions for potential reserve increases to No-Lapse Guarantee Universal Life (NLG) products. In support of Member Firm efforts to respond to inquiries from policyholders and advisors, and to provide more clarity and context, M Financial Group is providing information and commentary in this Due Care Update.

Please note that NLG refers to UL products offering guaranteed death benefit coverage, up to lifetime, if stipulated premiums are paid as scheduled.

Background

In response to a request by the New York Insurance Department, the NAIC requested that a subcommittee, the Life Actuarial Task Force (LATF), propose revised regulations that govern NLG reserves. The New York Insurance Department was concerned that current insurance company reserving requirements could be insufficient or could be interpreted in a way that appears to circumvent the spirit of the NLG reserving rules.

On November 1, the LATF subcommittee adopted proposed reserve language changes. The LATF adopted proposal is not binding from a legal or regulatory perspective. This is the first step in a lengthy process. The LATF adopted reserve language will now be sent to a larger committee for consideration on November 4. Following review by the larger committee, the proposed reserve language will be reviewed by the executive committee of the NAIC. At each point in the process there is opportunity for input from the industry and consumers, creating the possibility for changes or rejection. The current proposed reserve language is still open to interpretation and any measurable impact to insurance company earnings and insurance product pricing is purely speculative at this point. In addition, the proposal did not address whether changes would be applied retroactively.

The Wall Street Journal: Article Highlights

On November 1, 2011, *The Wall Street Journal* published an article titled "Insurer's Reserves Examined," which included the following commentary:

- State Insurance Regulators contend that some of the nation's largest insurers have improperly minimized reserves to meet claims from a popular type of life insurance coverage.
- If regulators insist on a more-stringent approach, the insurance industry could be forced to boost reserves by billions of dollars, crimping near-term earnings in the financial statements they submit to state officials.

- The officials haven't publicly named any alleged offenders, but Genworth Financial Inc., Lincoln National Corp. and Protective Life Corp. are among the insurers that have identified themselves as using the methodology now in dispute.
  - The insurers maintain that their current approach is appropriate and that their reserves are adequate.
- The regulatory body responsible for reviewing and recommending reserve changes, the Life Actuarial Task Force (LATF), is in an early stage of what could be a months-long deliberative process before any change in the industry's reserve requirements would take effect.
- Therese Vaughan, the NAIC CEO, said it doesn't necessarily mean that insurers are under-reserved in a way that threatens consumers because many regulators do agree with insurers that current standards in some instances "may produce excess reserves."
- Lincoln and other insurers say their reserves have been approved by their designated lead state regulators.

Summary/Analysis

While it is early in the process, the reserve proposal highlights continued concerns from regulators over the appropriate reserving level for guaranteed contracts and whether some companies are overly aggressive in their interpretation of the rules to allow for lower reserve levels, particularly in the current low interest rate environment.

The WSJ article suggests that if the proposed reserving methodology is ultimately approved by State Insurance Departments, it may result in (i) increased NLG premiums for new sales, and (ii) decreased earnings as a result of increased reserves for in-force policies. While those may be consequences of the reserving methodology changes based on varying interpretations, as proposed, the final approval process will be thorough, with review by the NAIC and opportunity for input from the insurance companies and ACLI.

The action referenced in the WSJ article is a preliminary recommendation of an NAIC subcommittee and is not binding. If questions arise from clients or advisors as a result of the article, the following points may be helpful to reinforce:

- Reserving standards are continually being reviewed to test for adequacy in light of new product designs and current conditions.
- The proposal is a recommendation for adoption and is not binding; the timing of adoption (including any modifications to the current proposal) or rejection is uncertain.
- The adoption (or rejection) process is very thorough with ample opportunity for input by State Regulators, the insurance industry, and consumers.
- The insurance industry, backed by the American Council of Life Insurers (ACLI), is opposed to the proposal, stating that the proposed reserves are excessive and not in the consumer's best interest.

- Historically, State Regulators have taken many months before adopting recommended reserve changes; there will likely be time for revisions to be made before potential adoption and implementation.
- Any commentary regarding impact on product prices and insurance company earnings is purely speculative at this point.

M Financial will continue to monitor this topic and will provide updates as further developments occur.

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