

## On The Way: New Minimum Valuation Standards for Health Insurance

by Paul Barnhart

At the June Meeting of the National Association of Insurance Commissioners (NAIC) in Kansas City, proposed new minimum valuation standards for individual and group health insurance were accepted for a six-month exposure period. Following exposure and possible revision, the new standards are expected to be adopted at the NAIC's December 1985 meeting.

The proposed new standards were presented in a report of the Subcommittee on Liaison with the NAIC Accident and Health (B) Committee of the Academy's Committee on Health, submitted to the NAIC Life and Health Actuarial Task Force. The task force, in turn, transmitted the report to the (B) Committee, which accepted it for exposure.

The report proposes significant changes in the existing accident and health valuation standards, the following being among the most important:

- *Clarification of the proper basis for dating of incurred claims, a key element in the determination of unpaid claim reserves.*
- *Determination of unearned premium reserves on a modified net unearned premium basis, providing for claims and expenses expected to be incurred during unexpired premium terms.* This new basis would give substantial relief to smaller and growing companies experiencing heavy surplus drain on account of heavily redundant gross unearned premium reserve requirements.
- *A new type of policy or "contract" reserve, called the "balancing reserve."* This reserve, based on anticipated loss ratios, would be required for all health contracts except guaranteed premium contracts and other contracts using level premiums and also providing only "scheduled" benefits or benefits based on fixed time period rates of payment, such as specified monthly disability income benefits or daily hospital combined benefits. Traditional tabular reserve requirements would continue to apply to guaranteed premium contracts and

to other contracts exempted from balancing reserve requirements.

- *Under certain conditions, balancing reserves would be transferable from contracts in a favorable financial position to those in a financially deteriorating excess loss position.* The purpose of such reserve transfers would be to provide some relief in situations where deteriorating experience is creating a vicious cycle of prohibitive renewal premium increases.

Members of the Academy who are interested in reviewing the subcommittee's entire report in detail may obtain a copy by contacting the Academy's Washington office. Members are invited to send written comments, suggestions, and criticisms to the Academy office also, directed to my attention.

It is expected that an opportunity will be provided for discussion of the report at one of the sessions of the 1985 Annual Meetings of the Academy and the Society of Actuaries in New Orleans on October 14-16.

*Paul Barnhart chairs the Subcommittee on Liaison with the NAIC Accident and Health (B) Committee of the Academy's Committee on Health. He also chairs the parent committee.*

**Insurance Trivia:** "George Armstrong Custer, at the time a lieutenant-colonel, took out a \$5,000 life insurance policy shortly before the Battle of Little Bighorn." *Curious Facts*, John May, et al., New York: Holt, Rinehart and Winston, 1980.

### QRA FLAWS

(continued from page 1)

However, the proposal does encourage discounting by imposing penalties for "over-reserving" in some cases.

- The QRA proposal has the result of imposing taxes on tax-exempt income. This is a subtle but logical corollary to the Treasury's position on internal build-up of interest income. The tax-exempt interest income is not taxable directly under QRA. However, the "underwriting profit" that results from the present value of the insurance cash flow discounted at the tax-exempt rate is taxable. Examples can be constructed where additional tax-exempt income generates additional tax liabilities.
- Under current tax law the traditional investment strategy is to invest in taxable investments in an amount sufficient to offset underwriting losses, with the balance of investments in tax-exempts. Under the Treasury proposal there will no longer be large underwriting losses, as the underwriting result is essentially calculated on a present value, rather than a nominal value basis. In the absence of these underwriting losses, the industry will probably find it desirable to shift back out of taxable investments and return to an investment policy that concentrates on tax-exempt investments.

Copies of this study are available from the Washington office.

## Annual Meeting Plans

Open forums, a business meeting, and panel discussions have been scheduled for the Academy's 1985 Annual Meeting to be held October 14-16 in New Orleans, Louisiana, this year in conjunction with the Society of Actuaries Annual Meeting. The Academy-sponsored sessions will cover the following topics: professional standards, new product accounting alternatives, the Internal Revenue Service Actuarial Guidelines Handbook, actuarial opinions on asset-liability matching, and legislation affecting group health products.

## Notice of Disciplinary Action

At its June 18, 1985 meeting, the Board of Directors of the American Academy of Actuaries adopted a recommendation from the Committee on Discipline to expel Paul Beecher from membership in the Academy.

The member had entered a plea of guilty on January 16, 1984 pursuant to a Plea Agreement recorded in the United States District Court of Illinois (Eastern Division) (Case 84 CR 10-1) to charges relating to the defrauding of a pension plan. The course of conduct was found to be in violation of Section 1(a), 2(b), 2(d), and 2(e) of the Guides to Professional Conduct.