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# Does It Seem to You that Valuation Mortality Tables Don't Last as Long Anymore?

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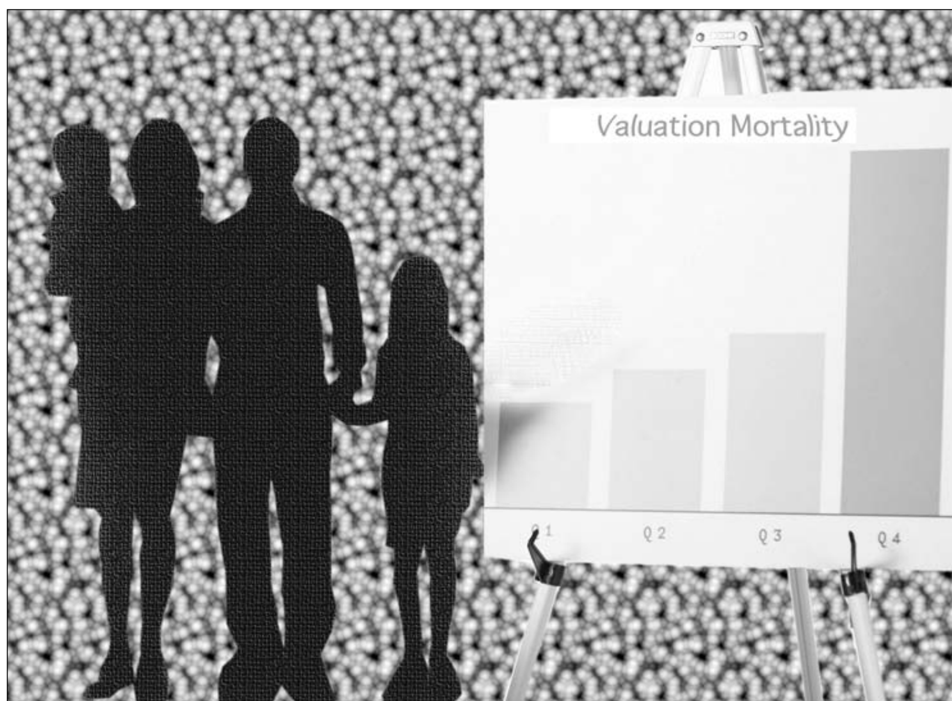


Most of us are currently implementing the new 2001 CSO Valuation Mortality Table for new product development. Numerous articles have been written about the table, transition strategies, tax issues and the like. One might think that with this new table, valuation issues would move to the back burner for a time. But this is not the case.

You may be aware of the principle-based versus formulaic reserve debate, the need for preferred risk mortality tables and the need for valuation tables for specialized products like PreNeed insurance. The purpose of this article is to provide a perspective on these issues, particularly as they relate to smaller-sized companies in the industry.

At the outset, I want to state that several of the following comments reflect my interpretation of current events and discussions in the valuation area. My hope is that by providing these insights, you will be encouraged to think about how various proposals and changes might affect your company.

To begin, two Project Oversight Groups (POG) have been appointed by the SOA to address issues related to preferred risk and specialized risk valuation tables. The first group is evaluating data and the need for a new PreNeed mortality table. This is a practical issue related to reserve adequacy in applying the 2001 CSO to PreNeed risks. At this point, we are in the data gathering phase of the work.

The second POG was more recently formed and is dealing with preferred risk issues. The need for preferred risk tables was expressed by a group of companies operating primarily in the UL and term markets. I was added to the POG to help represent the views of smaller companies toward a series of new valuation tables. I was surprised to find that data collection, analysis and development of these tables were slated for completion by April 2007. The NAIC has attached a sense of urgency to this project and the project schedule reflects a commitment by the SOA and others to respond to this need.

At a special meeting of the Life A Committee in Minneapolis on August 22 and 23, we found this timetable needs to be accelerated. My understanding is that the NAIC wants to push toward Principle-Based reserves for 2007, and therefore, needs the preferred valuation tables in 2006. These tables, with the 2001 CSO, provide a foundation for moving to the principle-based reserve approach. Of course, the NAIC is looking to the actuarial community to provide the basis for these new tables.

Options for the new tables range from completely new tables with preferred risk and residual mortality to subdivisions of the 2001 CSO, similar to the breakdowns of the 1980 CSO used for Nonsmoker/Smoker risks. Of course, rules will be needed to guide use of the tables. The 2001 CSO will continue as an optional table, but note that valuation actuaries will be able to select from a range of tables matched to expected mortality risks.

Throughout our committee conversations is the underlying current that these tables will provide a basis for valuation of business for those companies that use a standardized table and formulas for reserve determination. Principle-based reserves will provide an alternative basis for reserve determination based on company experience. There are many issues to be worked through, but what has caught my attention is the speed at which this process is moving forward.

Certainly, politics and special interests play a role in changes of this magnitude. We are all aware of proposals for federal regulation of insurance, such as the SMART Act and the optional federal charter. The NAIC has been battling these issues and establishing its case

that it is capable of regulating the industry in a progressive fashion. It now appears that at least some battle lines are being drawn around valuation issues.

There is no question that formulaic reserves are designed to produce conservative reserve totals for the industry as a whole. Statutory accounting has always had the safety of the industry at heart. However, the claim of many companies is that reserves are redundant and excessive, resulting in a higher consumer cost and a detrimental positioning of U.S. companies in an increasingly global market. As a result, we see pressure from larger companies for principle-based reserves and for federal regulation alternatives if states cannot respond quickly to these needs.

We have the computer power and tools to statistically evaluate reserve liabilities and establish confidence levels for appropriate reserve totals based on company dynamics. We can also recognize that options must be available for companies wishing to base reserves on standardized tables and methods that match mortality data to underwriting criteria—hence, the immediate need for preferred risk and specialized risk tables. All this makes sense in a progressive industry.

However, there is another aspect of these changes that creates concern for many companies. Small and even medium-sized companies are sometimes overwhelmed with the pace of changes and need time to absorb and implement new tables. And in this case, these changes may affect the very livelihood of some companies.

Consider the marketing balance between a large and small company for a moment. Let's say the large company bases reserves on its own data (principle based) whereas the small company uses standard tables and methods. Assuming the large company is able to hold lower reserves (otherwise they would choose standard tables), they will have an immediate advantage in a pricing element that heretofore was not in contention (effectively, valuation mortality served as a buffer between individual company experience and industry experience). This advantage may result in the larger company having reduced surplus strain, reduced overall reserve requirements and greater financial flexibility than the smaller company. This has the potential of upsetting an already fragile product market.

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Now, suppose the smaller company is able to evaluate its data and hold reserves based on its own experience. Further, assume the smaller company realizes the same mortality levels through their underwriting and market as the larger carrier. Even then, statistical analysis might suggest that the smaller company hold greater reserves due to volatility associated with the smaller volume of business. Once again, the smaller company may face a pricing disadvantage that currently does not exist.

There are other issues related to these changes that may result in varying perspectives based on your position in the market. As such, it is important to think through the balance that exists between companies of various sizes in the market and to reach conclusions that recognize that balance.

I believe it would be a mistake to underestimate the important role smaller companies play in the insurance market. Yet, the speed at which some valuation issues are advancing may not provide adequate time for smaller company executives and actuaries to fully appreciate the impact valuation changes make in the competitive market. I encourage all smaller companies to actively follow these matters and to voice their opinions so that issues important to this segment of our market are fully represented. ●

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