Small Talk

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Blast Emails Get SmallCo News Out Faster

By Mark Rowley

This article presents an update of recent blast emails sent to SmallCo section members.

One of the goals of the Smaller Insurance Company Section (SmallCo) is to disseminate items of interest to our members on a timely basis. One of the best ways to do this is to publish blast emails. In this article, I have included excerpts of blast emails that have been sent out over the last year. A benefit of being a SmallCo member is that you receive these blast emails and get the information more promptly than people who have to wait on the newsletter. I hope you find this information as interesting and useful as I do.

Life Insurance Valuation and Nonforfeiture Interest Rates May Drop (for business sold in 2013)

It is virtually certain that the most commonly used life insurance valuation rate will drop from its current 4 percent to 3.5 percent, to take effect with Jan. 1, 2013, issues. This would be the first change in the valuation rate since 2006. A lower interest rate will increase statutory and tax reserves, and affect the pricing/profitability of life insurance products.

Reserves for life insurance are determined using a valuation rate set by a formula in the Standard Valuation Law. The reference interest rate for life insurance is the lesser of the 36-month or 12-month average (of the composite yield on seasoned corporate bonds) for the period ending June 30 for contracts issued in the next calendar year. Since 2006, this valuation rate has been at 4 percent and the corresponding nonforfeiture rate has been at 5 percent.

The maximum nonforfeiture interest rate will drop from 5 percent to 4.5 percent, to take effect with Jan. 1, 2014, issues (companies are allowed a year to implement a nonforfeiture interest rate change). This will cause products to be refiled with insurance departments, unless they were filed with dynamic nonforfeiture information.

It is a good practice for company actuaries to monitor the pattern of interest rates. Three websites we have found helpful in monitoring interest rates are:

http://www.dfs.ny.gov/insurance/life/ilifemax.htm
http://www.lifebase.com/ValuationInterestRates.aspx
http://www.hauseactuarial.com/interestrates.asp

If interest rates get even lower in the future, the life insurance valuation rate could drop to 3 percent and the nonforfeiture rate would drop to 3.75 percent. This causes significant challenges related to whether life insurance using a 3.75 percent nonforfeiture rate meets the IRC Sec. 7702 definition of life insurance.

Federal Reserve Action to Keep Interest Rates Low

The Federal Reserve has taken action over the last few years to keep interest rates low in an effort to stimulate the economy. The Fed has the most control of the short end of the yield curve; the federal funds rate has been low for several years.

This allows banks to borrow at a very low rate and reinvest in Treasurys, making a spread without taking much risk. Of course, banks can also lend the money to consumers or businesses. The spread banks enjoy makes the Fed policy attractive for banks.

The same thing cannot be said for insurance companies. The impact of the Fed policy is to keep short-term rates low, but it also has some impact on all points of the yield curve. Insurance

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companies typically cannot borrow at the federal funds rate. Lower interest rates have compressed spreads for insurance companies, especially on older blocks of business with higher interest rate guarantees. This puts pressure on profitability.

At this time, we do not know how long interest rates will remain low. The Fed suggests it will hold rates low until 2014. However, the history from the Great Depression was that interest rates were low for the entire decade of the 1930s and were then climbing only very slowly during the 1940s and 1950s. If a similar pattern recurs, the stress on insurance company spreads might continue for a long time. On the other hand, if interest rates were to rise rapidly by 3 percent to 5 percent as they did in the 1970s, life insurance companies will experience stress from policy lapses as annuity policyholders move to higher-paying products. Neither a delayed slow rebound nor a fast rebound from low interest rates would be painless for the insurance industry. Of course, there are other scenarios, such as a gradual rebound in rates that starts soon, that would be much less painful. Given the uncertainty with interest rates, it is important for actuaries to test for a wide range of interest rate scenarios.

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People Who Aren't SOA Members Can Belong to SmallCo!

Just because a person isn't a member of the Society of Actuaries doesn't mean they can't be part of the Smaller Insurance Company Section.

SmallCo membership might benefit nonactuaries in companies without an actuary. Such a person can't use section membership to say they are an actuary or a member of the SOA, but they can get access to information that might help them do their job better.

Section membership might also benefit actuarial students.

If you know someone who is not an SOA member but might benefit from SmallCo, please recommend us to them. Contact Jerry Enoch at *JEnoch@alfains.com.*

Remember: Dues are only $25 per year.