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# smalltalk

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**W**hen I was attending the Valuation Actuary Symposium in September 2012, it struck me that now is the time for the Smaller Insurance Company Section (SmallCo) to focus on principle-based reserves (PBR). At the symposium we were told that the Valuation Manual would likely go into effect in 2015 or 2016, and I knew I was one of many actuaries who had consciously decided to not spend time keeping up with the latest developments, because progress had been so slow and spending time in other ways was more fruitful. Now, finally, it seemed like the perfect time to do this. In October 2012 SmallCo established the PBR Team to explore the implications of PBR on smaller insurance companies.

At the December 2012 NAIC meeting, the Valuation Manual passed very narrowly; and there are states like New York and California that were very vocal in their opposition. The PBR Team talked about this development and concluded that PBR may not be adopted, since to pass it needs the approval of 42 state legislatures which represent states with 75 percent of total premiums in the United States in 2008, and the vote at the NAIC was close. It is our understand-

ing that if the legislatures in California, New York and Texas vote against adopting PBR, it will not pass because they represent more than 25 percent of 2008 total premiums.

This was surprising to many people on the PBR team, and it changed our focus to first disseminate some information attempting to answer the question, "When should small company actuaries devote resources to PBR?" We shared this information in December 2012 on the section's website (<http://www.soa.org/Professional-Interests/Smaller-Insurance-Company/pbr-corner.aspx>) in the newly created "PBR Corner."

I am writing this article in late December at a time when the future of PBR is uncertain. Even so, the PBR Team plans to continue to work on putting together information to help prepare small company actuaries (and actuaries at larger companies) for PBR, because there is still a good chance PBR will eventually be adopted. We encourage you to visit the PBR Corner often. Even if PBR is not adopted, there are good concepts in PBR that would benefit all of us in our work, such as:

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## Chairperson's Corner

# The More Things Change, the More They Stay the Same

By Mark C. Rowley

**M**any things about the Smaller Insurance Company Section have changed over the last few years, and more changes are coming. A huge change is that we now have money in our bank account, which will allow us to do something for the very first time—fund research. More about that in a moment.

Why do we have money? One word: Webinars. We have been successful attracting actuaries to view our webinars, in part I am sure because they need continuing education; but I believe that a big part of this also is that our webinars have been of high quality. In 2012 the evaluations on our webinars were outstanding, and I know I personally learned some things that helped me do my job better. We have also benefited from opportunities to partner with other sections, something we are always looking to do.

Back to research. For the first time we have a research team. We can now participate in CLIR (Committee on Life Insurance Research) calls with an eye toward actually helping fund projects, which gives us the opportunity to influence the research in a way that is useful to small company actuaries. As I write this in late December, there are two projects we are monitoring for possible funding. A key way in which we plan to influence the project would be by placing a member or two on the Project Oversight Group (POG).

Another new thing is that we are implementing an international strategy. To do this, we first looked at our membership, and by far the country with the most international actuaries was Canada. This will be our starting point. We are almost ready to send a survey to these members to see how we can better serve them. We are also taking advan-

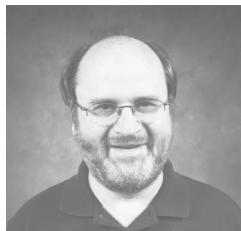
tage of a meeting being held in Toronto this year (the Life and Annuity Symposium) by having a section breakfast to further our efforts. We will see where all of this leads us.

So has anything stayed the same? Of course! It may appear that there is more change than anything else, but the core of our section, which is critical to our success, hasn't changed. I continue to thoroughly enjoy being involved. The networking I do and the friendships I have made both mean a lot to me. The networking clearly helps me be more effective in my role at my company. It is always stimulating to discuss issues with the smart and talented people involved with the section.

The most important thing that has stayed the same, thanks to Don Walker (and with credit to former SOA President Dave Holland), is the section's cheer:

e to the x dx dy  
radical transcendental pi  
secant cosine tangent sine  
three point one four one five nine  
two point seven one eight two eight  
Actuaries! Actuaries! WE ARE GREAT!  
YEAH, ACTUARIES!

What else could I possibly need? ●



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- Improving experience studies
- Improving assumption setting
- Improving documentation.

These initiatives are useful for improving asset adequacy analysis, pricing, and internal financial projections, as well as getting ready for PBR. Before launching efforts to improve assumptions and experience studies, it would be wise to review Section 9 of VM-20 (Requirements for Principles-Based Reserves for Life Products). Also, for companies with \$50 million or more of direct premiums, the experience reporting requirements will start when the Valuation Manual becomes operative (no three-year phase-in), so this may take on a sense of urgency. It will be useful to get familiar with VM-50 (Experience Reporting Requirements) and VM-51 (Experience Reporting Formats). It may make sense to design your experience studies using the data formats used in VM-50 and VM-51.

These are some of the topics we tentatively plan to cover on the PBR Corner in 2013:

- Impact of PBR by product, including impact on pricing/competitiveness

- Description of PBR's data reporting requirements
- How to get ready for PBR
  - Part 1—If you only expect to have to do exclusion tests
  - Part 2—If you sell products that will have their reserves change
- Requirements for documentation of assumptions and experience studies
- How to use the same model for asset adequacy and PBR
- Infrastructure needed to do PBR.

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# Pricing in a Low Interest Rate Environment

By Terry Long

**D**ue to the decrease in interest rates over the last several years, the maximum valuation interest rate for long duration life insurance (greater than 20 years) decreased from 4 percent to 3.5 percent effective for policies issued in 2013. By now, most companies have made changes to their valuation systems to support the new valuation interest rate.

The reduction in the maximum valuation rate also resulted in a decrease in the maximum nonforfeiture interest rate. With the new 3.5 percent valuation rate, the maximum nonforfeiture rate has decreased from 5 percent to 4.5 percent. Unlike the valuation interest rate, however, there is a one-year grace period for implementation of the nonforfeiture interest rate. The new 4.5 percent maximum nonforfeiture interest rate is optional for 2013 issues but will be mandatory for 2014 issues. Some companies have already implemented cash values based on the new maximum interest rate, but many are electing the one-year deferral. While there is no requirement that gross premiums change, most companies are repricing their products at the same time they implement new cash values.

- The lower valuation and nonforfeiture interest rates will result in larger basic reserves and cash values, which in turn will lead to increased surplus strain and reduced profit margins.
- Products that previously required deficiency reserves will likely require greater deficiency reserves in 2013 if gross premiums remain the same.
- Products that were not deficient in 2012 may now be deficient due to the larger net premiums and minimum reserves.
- Most importantly, the reduction in interest rates that led to the reduction in the valuation interest rate has also resulted in actual investment yields being lower, often significantly lower, than those assumed in pricing.

## Pricing Considerations

Pricing a product in the current low interest rate environment provides a challenge that most of us have not experienced. While we have experienced declining interest rates for a number of years, the general outlook was that they would soon level out or increase. Current indications are we will continue in the current environment for at least another year or two, and possibly longer depending on actions taken by the Federal Reserve.

- Should the pricing actuary assume that in the long term interest rates will increase and return to traditional levels? This will allow for more aggressive and competitive pricing, but there are obvious risks. If interest rates do not increase as quickly or as much as assumed in pricing, reduced profitability or even losses are possible.
- There is also the opinion of some that lower interest rates are the “new normal” and that products should be priced accordingly. While this approach will reduce or eliminate losses on the investment income assumption, it will also make it harder to compete with products that are priced differently.

Profit objectives are another factor companies are reviewing. Companies using internal rate of return (IRR) as a measure are evaluating whether they need to change their target. One justification is that historical IRR measures could be viewed as the then-current interest rates plus a risk premium. Under this assumption, a reduction in the underlying interest rates would justify a lower IRR. Selling this to senior management, however, can be a challenge.

Agent compensation is another area to review. While relatively few companies may have implemented more level commissions, pressure to do so is increasing.

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## Product Considerations

Companies are also reviewing the products they offer. Are there products that can be eliminated? Should new types of products be added to the portfolio? Some of the changes that have been made over the past few years include:

- Products that depend on interest spread, such as accumulation universal life, have become less favorable both for companies and consumers.
- Protection products, such as term insurance and universal life with secondary guarantees (ULSG), continue to be popular. But they have their own risks such as capital strain, long-term persistency risk for ULSG, and long-range mortality projections.
- Traditional whole life products have become more popular with consumers due to the guaranteed cash values. Low interest rates, however, are pushing companies to increase premiums and/or decrease dividends on the new products being introduced.

- Indexed products are also becoming more popular, but due to investment and marketing complexities, not all companies are in a position to enter this market.

## Planning for These Changes

If they have not already been made, decisions on how to proceed should be finalized soon. In addition to developing new products, changes to administrative, valuation and illustration systems will need to be made. These will require concerted efforts by marketing, actuarial and IT departments to have everything in place by the end of the year. Legal and compliance divisions will also be busy filing new and updated products. Since most companies will be filing multiple products this year, state insurance departments will be under more pressure. In response, a number of insurance departments have implemented procedures to help streamline the process for filings that involve changes due only to changes in the valuation or nonforfeiture interest rates. ●



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# Regulatory Update on Life and Some Health Insurance Issues as of Dec. 21, 2012

By Norman E. Hill

As before, this material remains extremely time-sensitive. Before its publication, readers should keep up with blast emails from the Society of Actuaries and other published sources for new material that could affect items enclosed.

## Principle-Based Reserves (PBR)—Approval Process

After seven years, this subject remains high on most lists. By now, everyone knows that the National Association of Insurance Commissioners (NAIC) Plenary has approved the package of a new Standard Valuation Law (SVL) and Manual (VM) for submission to state legislatures in 2013 to 2014. The A Committee had adopted an Aug. 17, 2012 version of VM, but, presumably, the Plenary intent on Dec. 2, 2012 was to adopt a version including numerous Life Actuarial Task Force (LATF) amendments adopted for exposure (by them) since Aug. 17, 2012. A comment from the NAIC president implied recognition of the importance of final adoption after all the years of effort.

The most current SVL version, with its 75 percent of premiums supermajority requirement, still specifies 2008 premiums. In any event, 2010 premium totals from the American Council of Life Insurers (ACLI) indicate that states with 23+ percent of premiums opposed Plenary adoption. If abstaining states are included, the opposition becomes 26+ percent. Several states were absent from the vote, which could also have an impact. This degree of support is far short of NAIC's normal desire for consensus.

To complicate further the question of approval:

1. At the November LATF, the ACLI proposed without a

written amendment that VM expand its optional implementation deferral from three years to five years.

2. New York has evidently proposed that some period of parallel reserve calculations (three to five years) be used. Current statutory reserves would be calculated, officially filed, but compared with reserves under PBR. The department implied that this change might overcome its opposition.
3. The actuary for the state of Kansas has stated that he would only take testimony from two insurers before his legislature to ensure rejection of the VM package.

I recommend that, in 2013 to 2014, actuaries try to monitor activity of their domestic legislatures, as to proposals for VM adoption.

## PBR—What to Do in the Meantime

With uncertainty of VM adoption, other articles have been prepared on what actuaries should study to gear up for PBR. My only recommendation now is that actuaries review carefully their current procedures for asset adequacy testing (AAT). A key question is whether asset adequacy reports can be used to satisfy VM20 (Requirements for Principles-Based Reserves for Life Products) requirements for the Stochastic Exclusion Test (SET). Interest, mortality, lapse and other assumptions may differ from Section 9 of VM20. Some actuaries use a 7.5 percent aggregate reserve margin to test deterministic reserves under AAT (based on LATF discussions from the 1990s.). The number of scenarios used in AAT may need expansion.

"I recommend that, in 2013 and 2014, actuaries try to monitor activity of their domestic legislatures, as to proposals for VM adoption."

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Even before VM approval and implementation, regulators may be scrutinizing AAT reports more carefully.

Another PBR aspect will require monitoring by some companies. In VM20, reserves for non-variable annuities (VM22) and health insurance, including long-term care and cancer (VM25), remain under current statutory requirements. But the stated intent is that some new PBR requirements will be required. These may not be completed until VM adoption by legislatures is complete (although not implementation). In such case, PBR requirements would be decided by the NAIC alone.

As a reminder, VM retains several PBR methodologies and requirements that many small insurers consider essential:

1. Availability of an actuarial certification to satisfy SET.
2. Resultant retention of statutory reserves for traditional products, which should include some term and traditional accumulation universal life (once defined).
3. Preneed products remaining exempt from PBR reserve requirements.
4. For companies with less than \$50 million in individual life premiums, exemption from mandatory experience reporting.

### Other Plenary Matters

The new 2012 Annuity Reserve Table was adopted for submission to the states. This table applies to both deferred and immediate non-variable annuities. A key provision requires annual adjustments for mortality improvement factors. These will apply retrospectively and prospectively to all issues covered under the table. The retrospective application of mortality improvements may require enhancements for some valuation systems.

### *Fixed Annuities with Guaranteed Living Benefit (GLIB) Provisions*

At the November LATF, there was considerable discussion on reserve procedures for these products. LATF was unable to choose from three options:

1. Retaining current valuation requirements under AG33—some have complained that this is too inflexible and results in redundant reserves. The “greatest present value” approach of AG33, without policyholder choice percentages, may overstate reserves.
2. Modify AG33 to allow use of these percentages for GLIBs.
3. Allow AG43, the guideline for variable annuities, for GLIBs. This would require stochastic processing, which might be unduly complex for small insurers.

### *Experience Reporting Under VM and Other Sources*

Mandatory experience reporting will be required for life and health products of most companies, including preneed. In my opinion, it will be some years before any data calls will be made for preneed, final expense or home service products. Even so, actuaries should review requirements of VM50 and 51 for data formatting requirements and their ability to accumulate data.

So far, the New York Department has conducted a mandatory pilot program for individual life mortality, using VM50/51 requirements. It intends to try another application for policyholder behavior, lapse and more. Its special aim is to try to capture behavior rates under universal life with secondary guarantees (ULSG), since reserves for these products will be key under PBR implementation.

### *PBR and Captives*

Use of captive insurers under NAIC regulations may not be relevant for small insurers, but the subject did arise recently and deserves a few points of discussion.

Both insurers and commercial companies have set up captives to hold property and casualty (P&C) liability reserves or reinsure life and health reserves. The NAIC recently issued a white paper discussing whether captives have been used to circumvent NAIC requirements for investments and reserves, such as under AG38. Once PBR is in effect, one of its aims is to eliminate perceived statutory redundancies.

South Carolina is one state with many domiciled captives. In my discussions with its actuary, Leslie Jones, she stated that they require captive adherence with all standard NAIC laws and regulations on investments, reserves and risk-based capital. But I checked my archives for work I had done with captives domiciled in another state. At that time, its captives were not tied to any of these standard laws or regulations.

Therefore, my only recommendation is that any small insurer considering captive formation should compare its advantages with PBR and also check special captive laws/regulations of the intended domicile state.

### *International GAAP (IFRS) and PBR*

At first, this might seem unrelated to PBR and statutory reserves. But subtle proposals at the NAIC are still on the table for substituting, i.e., scrapping U.S. statutory accounting for GAAP. This would apparently mean the new, still not finally adopted, International Financial Reporting Standards (IFRS).



In my opinion, any GAAP substitution of statutory reserves, after all the PBR work years, would create a firestorm from many companies. But a brief mention of current IFRS provisions is appropriate:

1. Reserves would be gross premium reserves—if underlying statutory departs from current formulaic, the possible federal income tax exposure in itself would be a firestorm.
2. Premiums, claims, expenses and regular current components would be shown in income statements. But “premiums” would be a form of YRT amount, definitely not meaningful current premium amounts.

### Summary

With no end in sight, actuaries from small insurers need to watch developments carefully, on a considerable number of fronts. ●

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# Smaller Insurance Company Section: 2012 Health Survey

By Joeff Williams

*“It is health that is real wealth and not pieces of gold and silver.”—Mahatma Gandhi*

*“The health of the eye seems to demand a horizon. We are never tired, so long as we can see far enough.”—Ralph Waldo Emerson*

Recently, the Smaller Insurance Company Section (SmallCo) conducted a member survey to better understand the issues of importance to our members who serve in the health area. The responses included a variety of comments and thoughts. When I was chairperson of SmallCo in 2010, we were unclear about the best way to support our health members. This continued to be an issue; so in December 2012 we decided to survey our members to get their input, and we thank all those who responded to the survey so that the council can better understand your needs.

There were 33 respondents out of 173 members surveyed (SmallCo has 551 members total)—a 19 percent response rate. This is a good response rate, which attests to the enthusiasm of the SmallCo membership. Even though the majority of the membership has identified with the life area, as the quotation above reminds us, practicing in the health field “it is health that is the real wealth.”

I first want to thank Dan Durow for his work in organizing the survey. One of the challenges encountered with the survey was defining the pool of recipients. The recipients were members who listed “Health” as a primary area of practice or listed any of the following as an additional area of practice: (1) Long-Term Care, (2) Health Benefits Systems or (3) Managed Care.

The survey had five questions, and a comments, suggestions or ideas section. The first question focused on what motivated the respondent to join SmallCo. The majority of respondents replied that they worked for or consulted with what they defined as smaller insurance companies and that they wanted to keep up-to-date on the current issues facing smaller insurance companies. Some of the issues articulated in the responses included: (1) ongoing Affordable Care Act (ACA) updates; (2) pricing, valuation and reinsurance issues; and (3) unique business challenges facing smaller insurance companies. The question was also raised about how to look at the continued viability of smaller companies competing in the health insurance market.

The next two questions asked respondents to highlight their likes and dislikes about SmallCo.

This is always a good way for the council to identify what things it can improve on to better meet members’ needs. The overwhelming response to what they liked about SmallCo was how the council focused on and dealt with relevant and real-world issues. The council does a good job of staying on top of current

issues and letting members know what they need to do their job in an everyday environment. Responses to the areas to improve question were fewer but consistently expressed a desire to focus on health matters in addition to the life issues. This is a challenge the council recognizes, and it will be looking at how to use the survey responses to better address that area.

The last question asked respondents to identify whether SmallCo is meeting their needs and expectations. It was encouraging to see that 90 percent of respondents said “Yes.” That still leaves 10 percent who need to be rec-

“The question was also raised about how to look at the continued viability of smaller companies competing in the health insurance market.”

ognized and to address how to improve the value of their membership.

To address some of these challenges, SmallCo has a buzz group session planned at the Society of Actuaries' Health Meeting in June. That buzz group will be an opportunity to talk specifically about current issues facing health actuaries who are working in or consult for smaller insurance companies. Also, SmallCo has planned a webinar in June that will focus on regulatory issues for smaller companies. One of the topics could be centered on health regulations such as ACA and/or rate regulations that may impact not only large companies, but even some small companies. There is also work being done on new morbidity studies that can be reviewed to evaluate their possible impact on smaller insurance companies.

The challenge the council faces is how to recognize the needs of a subsection of the membership while engaging the volunteer resources needed to contribute to those members in their everyday work demands. The continuing issue of competitiveness and viability of smaller insurance companies in the health market will be an issue that the council will need to consider with respect to the health membership.

If you did not have a chance to participate in the health survey, have any additional thoughts or suggestions, or would like to volunteer to help the council serve the health membership within SmallCo, please feel free to contact myself or Dan Durow at [dtdurow@nglic.com](mailto:dtdurow@nglic.com). ●

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## Professional Guidance Webinar—You Don't Want to Miss It!

The Smaller Insurance Company Section had a great attendance at its variety of webinars in 2012. The section is keeping up that positive momentum with another group of important, thought-provoking events.

The first in the line-up is "Professionalism—Modeling for Small Companies." This webcast will discuss the evolution of current life insurance and annuity modeling practices and explore key emerging issues that small company actuaries face with respect to modeling.

Check SOA's Professional Development Calendar at <http://www.soa.org/PDCalendar.aspx?type=session> for these other important webinars sponsored by the SmallCo Section.

Regulatory Issues for Small Companies—June 4, 2013.  
Overview of PBR for Small Companies—Aug. 20, 2013  
Financial Reporting Issues and Considerations for Year-End 2013—Dec. 10, 2013

**Webcast Date:**  
**March 19**

**Sign-up Deadline:**  
**March 15**



## SmallCo and Its Members Add Value at SOA Meetings

SMALLER COMPANY CHIEF AND CORPORATE ACTUARIES FORUM WAS THE HIGHEST-RATED SESSION AT THE VALUATION ACTUARY SYMPOSIUM

By Don Walker and Jerry Enoch

**T**he Smaller Insurance Company Section (SmallCo) has played a significant role at recent Society of Actuaries (SOA) events. Here are some examples.

### Valuation Actuary Symposium

At the Valuation Actuary Symposium (Los Angeles, Sept. 9–11, 2012), SmallCo sponsored three well-regarded sessions and had a significant presence in several others.

#### *Smaller Company Issues (Buzz Groups)*

Don Walker (coordinator)  
Tim Cardinal, Grant Hemphill, Alice Fontaine, Pete Hitchcock and Jerry Enoch (facilitators)

This was our buzz group session, where our members and friends were able to gather together in small groups to discuss issues of mutual interest. This session had 32 attendees and received an overall rating of 4.23 on a five-point scale.

#### *How Can Smaller Companies Respond to the Low Interest Rate Environment? (Workshop)*

Mark Rowley and Bob Guth (session leaders)

This session leveraged the work of SmallCo's Low Interest Rate Team. Two of the team members led a workshop session to discuss the challenges of the low interest rate environment and possible solutions available to small companies. This session had 33 attendees and received an overall rating of 4.41.

#### *Smaller Company Chief and Corporate Actuaries Forum (Open Forum)*

Mark Rowley, Don Walker, Norm Hill, Mike Kaster and Terry Long (session leaders)

This session, which immediately follows the Valuation Actuary Symposium, allows a group of lead actuaries at small companies, augmented by consultants who work with small companies, to come together for a luncheon and a series of discussions on issues of the day. It's a bit more structured than the buzz group session and lasts longer, allowing more in-depth exchange of ideas. Nineteen of us gathered to get an update on principle-based reserves from Norm Hill, participate in some opinion polling led by Mark Rowley, and hear thoughts from the other leaders. This session received an overall rating of 4.77, the highest rating of any session at the Valuation Actuary Symposium! Mark got the highest individual rating of any speaker at the Valuation Actuary Symposium, and all five leaders received top 10 scores.

#### *Other Sessions*

SmallCo members Karen Rudolph, Narayan Shankar, Pam Hutchins, Don Walker and Jerry Enoch also presented at other Valuation Actuary Symposium sessions, including an innovative forum led by Jerry in which the participants experienced a congenial discussion with three state regulators.

### Annual Meeting

At the SOA annual meeting (Washington, D.C., Oct. 14–17, 2012), SmallCo sponsored four sessions.

#### *Hot Breakfast*

Jerry Enoch and Leon Langlitz (leaders)

SmallCo kicked off the annual meeting with a well-attended section breakfast on the opening morning. After informal discussion at breakfast and very brief comments about the section from outgoing chairperson Jerry Enoch, attendees were the first to hear results of the comprehensive survey of appointed actuary practice, which was spearheaded by SmallCo. Survey co-leader Leon Langlitz explained some

of the survey results of greatest interest to small company actuaries, leaving the audience anxious to see the entire survey.

*Current Topics Impacting the Smaller Insurance Company (Buzz Groups)*

Philip Ferrari (coordinator)  
Sharon Giffen, Leon Langlitz, Mike Kaster, Chris Hause and Philip Ferrari (facilitators)

This was our ever-popular buzz group session, where attendees discuss topics of their choosing in small groups. Besides exchanging information, these sessions allow small company actuaries to see old friends and make new friends from small companies.

*Reinsurance Challenges for Medium and Small Companies (Open Forum, co-sponsored with the Reinsurance Section)*

Mike Kaster (coordinator)  
Julie Hunsinger, Jean-Marc Fix, Larry Stern and Mike Kaster (facilitators)

We had a very interactive session with the audience discussing the many challenges smaller companies face in obtaining reinsurance. With the help of several questions designed to pull in the audience, our panel was able to give a good picture of the current reinsurance market and some alternative strategies for small insurance companies.

*Low Interest Rates: Financial and Product Implications (Interactive Forum, co-sponsored with the Financial Reporting Section)*

Bill Sayre, Terry Long and Jerry Enoch (facilitators)

This session was designed as a workshop, but it filled up almost immediately, and its format was changed to accommodate the demand for this hot topic. Bill Sayre primed the pump by providing some provocative information about the low interest environment and raising some concomitant issues. Then the group was free to address different aspects of the low interest environment, as in a large workshop.

Our involvement at meetings is another example of how SmallCo works to help actuaries of smaller insurance companies better perform their jobs. SmallCo is very active and encourages involvement by others. If you are interested, we can help you find a place where you can contribute successfully and learn while doing it. Contact Chairperson Mark Rowley ([mrowley@emcnl.com](mailto:mrowley@emcnl.com)). ●

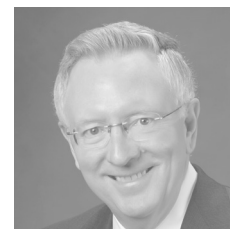
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# H SOA 2013 HEALTH MEETING



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