SOCIETY OF ACTUARIES

July 31, 2014

To: Reggie Mazyck, NAIC

From: Steven Siegel
        Society of Actuaries (SOA) Research Actuary

cc: Sam Gutterman, Tim Harris co-chairs, SOA Committee on Life Insurance Company Expenses
        (CLICE)

Re: SOA 2015 Generally Recognized Expense Table (GRET) Analysis

As in previous years, the Society of Actuaries expresses its thanks to NAIC staff for their help and responsiveness in providing Annual Statement expense and unit data for our 2015 GRET analysis for use with individual life insurance sales illustrations. Our analysis is based on expense and expense related information reported on companies' 2012 and 2013 Annual Statements. This analysis has been completed to assist the Life Actuarial Task Force (LATF) in its consideration of potential revisions to the GRET that could become effective for calendar year 2015. This memo describes our analysis and resulting findings.

NAIC staff provided Annual Statement data by life insurance company for calendar years 2012 and 2013. This included data from 788 companies in 2012 and 768 companies in 2013. The primary reason for the lower number of companies in 2013 is that some companies had not submitted their data to the NAIC by the date the data extract was provided to us. Note that this relative difference in number of companies between years is consistent with prior experience with this data. Because we subsequently excluded certain companies' experience because of an outlier exclusion test, the absence of these late reporting companies is not expected to significantly affect the results. Of the total companies, 367 passed the outlier exclusion tests and were included as a base for the GRET factors (this is higher than prior years, 277 last year, because a reinsurance exclusion test was applied last year, so that companies that ceded a significant portion of their business, for example, to captive insurers, were eligible to be included in this year's analysis).

The methodology we followed for calculating recommended GRET factors based on this data is similar in broad outline to that followed last year, with several changes highlighted in the following (most of these changes had been discussed a year ago with LATF). Please refer to the submission for the previous year for a more complete description of the process previously followed. Significant changes included:

1. Distribution channels. Categories of distribution channels were reduced in number and simplified. This change was made in response to the evolution of the marketing of individual life insurance and we have been told that it was increasingly difficult to determine a single mode of distribution for many companies, as they had characteristics of several of the existing distribution channel types.

Previously, eight categories were used, reduced to five in this year's recommendation (a translation between them used for purposes of carrying forward the results of prior survey results is provided in Appendix A where we did not receive a response in this year's survey, although it is recognized that this translation may not be perfect in every situation). They are: (1) independent, (2) career, (3) direct marketing, (4) niche marketers, including home service and pre-need coverage, and (5) other. A description of the distribution channels are provided in Appendix A (in addition, a description of the previous categories are also given). Note that the assignment of distribution channel by company was based on our annual surveys of insurers – a choice of "other" was not an option; in most cases companies in the other category were non-respondents to our surveys.

We welcome advice and assistance from LATF in future years to increase the response rate to our annual surveys of companies that submit Annual Statements in order to reduce the number of companies in the "other" category.

2. Treatment of multiple distribution channels. Last year, if in our survey a company indicated that they used multiple channels to distribute their individual life sales, the corresponding percentage weights provided to us were applied to that company's reported results in the tabulations of each of the distribution channel's unit expense results. For this year's recommendation, this approach was not used because: (1) as fewer channel types were used, it was expected that fewer companies would have multiple channels as currently defined and (2) an insufficient number of multiple distribution responses were provided in this year's survey to result in a sufficiently different outcome. We intend to continue surveying the companies in future years to enable enhancement of this multiple distribution channel information; in future studies our approach will be revisited.

3. Unit expense seed. In prior years, our analysis used unit expense allocations based on a LOMA unit expense study conducted in 1997. Since that time, the structure of unit expenses has changed considerably. The current seed used was not deemed representative of current relative unit expenses. As a result, we reviewed the results of past annual Society of Actuaries' expense studies for data on which we could base updated allocations. We developed a new set of unit expense seeds (relativities that implicitly allocate expenses between (non-commission) acquisition and maintenance expenses, and between the three unit bases over which acquisition expenses are allocated). In previous studies, separate seed values were used for branch office distribution and all other; however, because branch office is no longer a separate distribution channel category, we believe it appropriate to base the 2015 GRET on a single set of unit expense seeds, undifferentiated by distribution channel. The set of unit expense seeds (recommended and previously used, along with results from the 2006-2010 SOA studies) are given in Appendix B.

4. Reinsurance exclusion test. This test, which eliminated from GRET calculations companies with a significant amount of reinsurance commissions, was previously used to eliminate companies with a large amount of ceded or assumed reinsurance. Its application had resulted in eliminating a significant number of companies, including certain companies with captives.

This test was not applied in developing the calculations for this year's GRET recommendations. Since the GRET calculations were performed on a direct of ceded reinsurance basis and professional reinsurers were excluded in any case, it was determined that these exclusions were not necessary. This had the effect of significantly increasing the number of companies included (277 to 367) in the GRET calculations, as indicated in Table 1.

To calculate updated GRET factors, the average of the factors from the two most recent years (2012 and 2013 for those with data available for both years) of Annual Statement data was used. For each company an actual to expected ratio was calculated. Unit expense seed factors, as given in Appendix B, were used to compute total expected expenses (note that the seeds for all distribution channel categories are now the same). Thus, these seed factors were used to implicitly allocate expenses between acquisition and maintenance expenses, as well as among the three acquisition expense factors (on a direct of ceded reinsurance basis). Companies were excluded from the analysis if (1) their actual to expected ratios were considered outliers, often due to low business volume, (2) their total individual life insurance non-commission expenses were less than $50,000, for which their ratios were not deemed credible, or (3) they are reinsurance companies. No specific reinsurance exclusion test was applied; as indicated above, as a result many additional companies were included this year from the calculations that were excluded last year. To derive the overall GRET factors, the unweighted average of the remaining companies' actual-to-expected ratios for each respective category was calculated. The resulting factors were rounded, as shown in Table 1.

In previous recommendations, an effort was made to reduce volatility from year-to-year in the factors by limiting the change in GRET factors between years. However, given the changes in the unit expense seed and distribution channel categories and that, as a result, the change can vary by policy (depending upon the relationship between premiums, face amount and expected policy duration of each policy), this simple capping/flooring of changes in values could not be performed. Consequently, no such cap or floor was utilized this year. We will revisit this process in next year's recommendations, with a similar cap and floor for changes likely.

Employing the above methodology results in the proposed 2015 GRET values as shown in Table 1. To facilitate comparisons, the current 2014 GRET factors are shown in Table 2.

Further characteristics of the type of companies represented in each category are included in the last two columns in Table 1, including the average premium per policy issued and average face amount ($000s) per policy issued.

TABLE 1
PROPOSED 2015 GRET FACTORS, based on average of 2012/2013 data

Distribution Channel	Acquisition			Maintenance per Policy	Company Count*	Average Premium per Policy Issued	Average Face Amount ($000) per Policy Issued
	per Policy	per Face Amount ($000)	per Premium				
Independent	$146	$ 0.80	36%	$44	124	$6,048	$255
Career	235	1.30	59	70	75	2,265	197
Direct	161	0.90	40	48	22	1,503	109
Niche	136	0.70	34	41	26	768	19
Other*	150	0.80	38	45	120	4,879	145
Total					367		

*Those companies who are included in the "other" category are those companies that did not respond to this year's survey or that of prior years (for those that responded in prior years, a translation between their prior distribution channel assignment and the new set of categories was made).

TABLE 2
Current (2014) Factors

Distribution Channel	Acquisition per Policy	Acquisition per Face Amount ($000)	Acquisition per Premium	Maintenance per Policy
Branch Office	$ 73	$ 1.30	80%	$ 36
Direct Marketing	74	1.40	41	37
Home Service	77	1.40	42	38
Career General Agency	91	1.60	50	46
Brokerage	85	1.50	47	42
PPGA	91	1.60	50	46
Multiline	144	2.60	79	72
Other	99	1.80	54	50

Also asked in this year's survey, responded to by companies' Annual Statement correspondent, was a question regarding whether the 2014 GRET table was used by the company. Last year, the first time this question was asked, about 20 percent of the responders indicated that the company used the GRET for sales illustration purposes, with similar results by type of company. This year, 31.6% of companies that wrote any new individual life insurance business during 2013 and responded to the survey indicated they used the GRET in 2013 for sales illustration purposes (38 out of 120). By distribution channel, 31% of companies using an independent distribution channel, 33% of companies that used a career distribution channel, 44% of direct marketers and 22% of niche marketers indicated they used the GRET. We believe that this apparent increase in GRET use is in part due to the relatively small sample size in these two surveys.

We hope you find this information helpful and sufficient for LATF's consideration of potential update to the GRET. If you require further analysis or have questions, please contact me at 847-706-3578.

Sincerely,

Steven Siegel
Society of Actuaries Research Actuary

Appendix A -- Distribution channels

The following is a description of distribution channels used in the development of recommended 2015 GRET values:

1. Independent – Business written by a company that markets its insurance policies through an independent insurance agent or insurance broker not primarily affiliated with any one insurance company. These agencies or agents are not employed by the company and operate without an exclusive distribution contract with the company. These include most PPGA arrangements.

2. Career – Business written by a company that markets insurance and investment products through a sales force *primarily* affiliated with one insurance company. These companies recruit, finance, train, and often house financial professionals who are typically referred to as career agents or multi-line exclusive agents.

3. Direct marketing– Business written by a company that markets its own insurance policies direct to the consumer through methods such as direct mail, print media, broadcast media, telemarketing, retail centers and kiosks, internet or other media. No direct field compensation is involved.

4. Niche marketers – Business written by home service, pre-need, or final expense insurance companies as well as niche-market companies selling small face amount life products through a variety of distribution channels.

5. Other – Companies surveyed were only provided with the four options described above. Nonetheless, since there were many companies for which we did not receive a response (or whose response in past years' surveys confirmed an "other" categorization (see below), values for the Other category are given in the tables in this memo. It was also included to indicate how many life insurance companies there were with no response (to this survey and prior surveys) and to indicate whether their exclusion has introduced a bias into the resulting values.

The following is a description of distribution channels used in the development of 2014 and earlier GRET values:

1. Branch Office - A company or division which operates an agency building system featuring field management that are employees although their compensation may be largely based on production. The company provides significant employee benefits to field employees in addition to direct compensation.

2. Direct Marketing - A company or division that markets directly to the public through printed or other media. No direct field compensation is involved.

3. Home Service - A company or division that markets smaller insurance policies through an organization that resembles the Branch Office system in organizational and compensation structure but focuses on smaller policies and agent collections of premiums. Note that this request focuses only on the distribution of ordinary life business, not considering any industrial business written by a company.

4. Career General Agency - An agency-building system using full-time agents who report to managers who are company employees or general agents who are independent contractors.

5. Brokerage - A system that uses independent producers (brokers) who are contracted with multiple companies. The bulk of their income comes from overrides rather than personal production. This includes managing general agents and independent marketing organizations.

6. PPGA - A system that uses independent personal producing general agents (PPGAs) who are often contracted with multiple companies. The bulk of their income comes from personal production rather than overrides.

7. Multi-Line - A system that uses full-time agents licensed to write property-casualty, life, health, annuities, and equity products and who primarily represent one company.

8. Other - Companies or divisions other than those described above. If you choose this category, please provide a brief description of the distribution system for your company's ordinary life business.

For those companies that did not respond to this year's survey of companies, the following translations from the eight distribution channel categories above to the five distribution categories were made.

- Branch office → Career
- Direct marketing → Direct marketing
- Home service → Niche marketing
- Career general agency → Career
- Brokerage → Independent
- PPGA → Independent
- Multi-line → Career

Appendix B – Unit Expense Seeds

The recommended expense seed was differentiated between branch office and all other categories, due to a belief that branch office acquisition cost expressed on a per Face Amount basis should be given double the weight. Due to the elimination of the branch office category, it was felt that a non-differentiated unit expense seed was appropriate at this time.

The unit expense seed used in the 2015 GRET recommendation was based on the average of the 2006 through 2010 Annual SOA expense studies. These studies differentiated unit expenses by type of individual life insurance policy (term and permanent coverages). As neither the GRET nor the Annual Statement data provided differentiates between the two types of coverage, the unit expense seed was derived by judgment based on this information. The following provides the earlier used LOMA seed, the averages derived from the Annual SOA studies and the recommended seed used.

Original LOMA unit expense seed:

	Acquisition/ Policy	Acquisition/ Face Amount	Acquisition/ Premium	Maintenance/ Policy
Branch office:	$ 63.13	$ 1.123	69.9%	$ 31.59
All others:	$ 63.13	$ 1.123	34.8%	$ 31.59

2006-2010 (average) CLICE studies:

	Acquisition/ Policy	Acquisition/ Face Amount	Acquisition/ Premium	Maintenance/ Policy
Term - weighted average	$ 149	$ 0.62	37.9%	$ 58
Unweighted average	$ 237	$ 0.80	56.8%	$ 76
Median	$ 196	$ 0.59	38.1%	$ 64
Perm - weighted average	$ 167	$ 1.43	41.7%	$ 56
Unweighted average	$ 303	$ 1.57	49.4%	$ 70
Median	$ 158	$ 1.30	41.1%	$ 67

Recommended unit expense seed:

	Acquisition/ Policy	Acquisition/ Face Amount	Acquisition/ Premium	Maintenance/ Policy
All distribution channels	$200	$ 1.1	50%	$ 60

Formula for Premium Used in GRET Calculations:
[First: direct ordinary life (Page 9, line 9.1)] + .06*[[Single: direct ordinary life (Page 9, line 10.1)] – [Life dividends and refunds to PUA's (Page 11, Exhibit 4, Line 3, column 1)]]