TRANSACTIONS OF SOCIETY OF ACTUARIES
1959 VOL. 11 NO. 30AB

Active Life Reserves

A. Are standardized minimum reserve requirements feasible in view of the complex variety of coverages?
B. Will minimum reserves recommended by Task Force IV and adopted by NAIC prove to be a serious strain on surplus in view of the limitation of persistency assumptions to CSO mortality alone?
C. Is it appropriate to maintain active life reserves on cancelable business? If so, what are the problems involved?

MR. HAROLD J. BROWNLEE stated that he very much approved of the recommendation of the Task Force IV Committee with respect to benefits for which reliable insurance statistics have not yet been accumulated, *i.e.*, "Each insurer should determine and maintain reserves which place a sound value on the policy liabilities." He intimated that only the most popular plans would develop sufficient data to serve as a reliable basis for reserves. He also felt that the minimum reserves recommended by Task Force IV might not prove to be a serious strain on surplus, depending on the distribution of business by plan, age and duration. He suggested that the best means of determining the extent of the strain would be a model office calculation. Such calculations would preclude the considerable danger that the excess of the early years' premium over the cost of providing the insurance might be paid out as dividends.

MR. EDUARD H. MINOR stated that it had been the practice of the Metropolitan, for some years, to maintain active life reserves on cancelable loss-of-time policies. This reserve is computed on a 10-year preliminary term valuation basis. He stated that these reserves are weighted by occupational class factors where appropriate and pointed out that, on policies issued at lower than current premium rates, a check is made to see whether the gross premiums less expenses after the 10th policy year are at least equal to the net valuation premiums. He pointed out that the first midterminal reserve at the end of the 10th policy year amounted to only about 6% of the premium and that subsequent yearly increases in the reserve required only 10% of the premium for the years of issue involved. After about the 20th policy year, reserves tended to decrease. He stated that such reserves were not included in the Annual Statement as active life reserves but rather as a special liability under the heading, "Special Reserves for Morbidity Fluctuations on Certain Accident and Health Policies." It was his feeling that only through the accumulation of reserves of this nature was it possible for a company to make a decision as to the desirability of continuing the coverage on policies persisting to the normal expiry age of the policy.

MR. CHARLES N. WALKER stated that he would reply emphatically in the negative with regard to the feasibility of standardized minimum reserve requirements. He pointed out that it would be unfortunate if the early calculations based on scanty data, published by himself and others in connection with major medical and other new and experimental coverages, were too hastily adopted as bases for reserves. He would much prefer to see a flexible system under which any reserve table which could be demonstrated to produce adequate reserves would be acceptable as a permissible valuation standard. He thought that this would be particularly appropriate in the case of hospital expense coverage subject to deductible amounts.

He mentioned that some recent calculations of reserves indicated that it might be mathematically accurate to have lower reserves for deductible policies than for nondeductible. He gave an example of a policy with a $12 daily benefit and a $25 deductible clause for which the reserves tended to be about 85% of the corresponding policy with no deductible provision, such reserves being quite independent of either age or duration.

Mr. Walker went on to say that the same type of differences in reserves would be encountered with respect to miscellaneous expense benefits subject to deductible amounts and intimated that the higher the deductible the less difference there might be by age. Consequently, a considerable reduction would be allowed in the reserve as compared to the nondeductible type of policy.

With regard to whether minimum reserves would be a strain on surplus, Mr. Walker stated that a model office study recently prepared for hospital business indicated that the inclusion of an active life reserve equal to the difference between the Task Force IV minimum requirements and the regular gross unearned premium reserve would not be such as to require any additional reserve until the end of the fifth policy year, and then only about 3% of the premium. Thereafter, the increase in reserve would be in the neighborhood of 5% of the premium, not reaching 6% until about the 15th calendar year of operation. Mr. Walker did not feel that such a reserve accumulation would impose a burdensome strain on any company.

With regard to active life reserves on cancelable business, Mr. Walker pointed out that the Lincoln National has maintained such reserves since the inception of their business, using a 5-year preliminary term basis. He felt that the new tax law was indefinite with respect to any additional reserve set up on cancelable business. He would conclude that it may not be permissible to make use of such an amount as a reserve deduction. He thought this might tend to create a difficult situation in the case of policies which might not be entirely guaranteed as to renewability but might become subject to state reserve requirements while not within the definition used by the federal government in allowing reserve deductions.

MR. MINOR called attention to the tax regulation which apparently makes it possible to recalculate noncancelable reserves on a full net level reserve basis even though the reserve shown in the Annual Statement may have been on a preliminary term basis.