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From the Editor

by James R. Thompson

Marketing Problems

Companies these days seem to be looking for approaches to increase sales. One approach they are trying is database marketing. Another is worksite marketing. Larger companies often create strategic business units to work on this or otherwise have large resources. We will explore how best to handle these approaches to new sales within the budgetary constraints of the smaller company.

A recent issue of the *National Underwriter* (August 31) carried some articles on these themes. Some of the authors were contacted and have contributed other material they have written to this issue of *small talk*.

If you have policyholders on a database, you have potential leads. How and when to contact them can make for a successful strategy for increasing your application count. Large companies have extensive staffs they can devote to this. How can the smaller company make efficient use of their database? Wallace Dale has contributed an article on database marketing entitled, "Collaborative Database Marketing."

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Small Company Update on XXX

by James N. Van Elsen

It seems that I have been saying throughout my whole career that "XXX is coming." Every time, I truly have believed that nothing could stop it. Well, one more time, XXX is coming!

For those who have not been following this regulation, XXX is a name that has been used to identify a new individual life insurance valuation regulation. Although it was primarily designed to affect reserves for individual term life insurance, it may ultimately affect all individual life insurance products. There are currently a few exclusions in the draft regulation, but even these are under review.

The driving force behind XXX this time is the states of Wisconsin and New York. A version of XXX has been in effect in New York since 1994. This has not had a major impact on the industry due to the relatively small number of companies that are licensed in New York. Wisconsin, however, recently adopted XXX with an effective date of January 1, 1999. This has the potential of affecting significantly more companies.

An Ad Hoc Industry Committee has been working to develop an alternative version of XXX. While much work remains, it now appears that the committee may succeed in having the NAIC adopt this alternative regulation. Based on the success of this group, Wisconsin has indicated that they will move the effective date of their regulation back to July 1, 1999. If the Ad Hoc Industry Committee is successful, it is anticipated that Wisconsin will adopt it, moving the effective date back to January 1, 2000.

> ***"The new version of XXX will become effective for most companies on January 1, 2000."***

Current Status

The following is a summary of the status of XXX as of October 13, 1998.

- Exposed for discussion by the NAIC's Life & Health Actuarial (Technical) Task Force and the "A" Committee on September 12, 1998.

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Copy can be downloaded from the NAIC's web page at http://www.naic.org/committe/modelaws/0698docs/3xre1.doc

- NAIC's Life & Health Actuarial (Technical) Task Force may adopt it at the December meeting in Orlando.
- NAIC's "A" Committee may adopt it at the December meeting in Orlando.
- NAIC's Executive Committee may adopt it prior to the March meeting in Washington, D.C.
- NAIC may adopt it as soon as the March meeting in Washington, D.C.
- Several states are expected to adopt it during 1999, including Illinois and Wisconsin. Other states are expected to join this list.
- The new version of XXX will become effective for most companies on January 1, 2000.

If the Ad Hoc Industry Committee is unsuccessful, Wisconsin and several other states are expected to adopt the previous version of XXX very quickly. In any event, most companies are expected to be affected by XXX by January 1, 2000.

Small Company Aspects

There are several aspects of the proposed XXX that should be reviewed by smaller companies. These include:

- The "X" factor.

The proposed regulation has an "X" factor that is used for deficiency reserves. This factor, which may be a vector, is multiplied by the 1980 CSO mortality table to arrive at valuation mortality for deficiency reserves. It is expected that the Actuarial Standards Board may develop an Actuarial Standard of Practice to guide appointed actuaries in establishing "X."

It will be more difficult for smaller companies to justify aggressive values of "X." They will be much less able to use their own experience to document the anticipated level of mortality. They will be forced to rely on industry experience. This may also force them to work with reinsurers to justify "X" based on reinsurance premiums or pooled business. It is unclear at this point what options will be available to smaller companies for justifying experience.

If "X" is less than 100%, a company must prepare a Section 8 Actuarial Opinion (Asset Adequacy Analysis). In addition, companies will be required to prepare an actuarial opinion and report justifying the use of any "X" factor less than 100%.

Finally, the impact of future changes in "X" on smaller companies can be devastating. For example, let's say that the appointed actuary establishes "X" at 40% for a new series of term products. As experience evolves, it may become apparent to the appointed actuary that 80% is necessary. The company will be forced to recalculate deficiency reserves at that time based on the 80% "X" factor. It's possible that this product previously had no deficiency reserves. The company may now discover that the product has very significant deficiency reserves, perhaps enough to impair the company.

It is important, therefore, that the appointed actuary be very careful in establishing the "X" factor. A too aggressive assumption may later be disastrous for the company. It may be necessary for the company to seek some reinsurance protection from adverse results of increases in "X."

- Valuation complexity.

For products that are affected by XXX, the reserve calculations can be complicated. This may necessitate modifications to valuation systems, or even new valuation systems. This will also complicate the pricing models that a company uses to develop new products. Smaller companies do not generally have as many resources that can be devoted to these valuation projects. To remain competitive in the term market, however, companies will be forced to implement these changes.

- YRT reinsurance exemption.

There is an exemption in the regulation for "true" YRT reinsurance. Contracts which meet certain definitions are exempt from the requirements of XXX. The ceding company reserve credit, however, will be limited to the amount of the reserves held by the assuming company for this business.

- Universal life products.

Universal life insurance has traditionally been the product choice of many smaller companies. XXX specifically addresses reserving issues for universal life policies with secondary guarantees. Essentially, the secondary guarantees (some companies refer to these as no-lapse provisions) will be treated as a term product within the universal life product. The company will be required to hold the greater of the normal universal life reserve or the reserve developed by XXX.

If XXX becomes effective in the year 2000, it can be expected to significantly change the individual life insurance marketplace. As noted above, some of the provisions of XXX need to be reviewed by smaller companies. It will be extremely important for smaller companies to monitor the progress of this regulation, and to develop plans for adjusting for the impact of this regulation. Failure to respond appropriately to this regulation could be very costly to smaller companies.

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