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August 5, 2016

To: Reggie Mazyck, NAIC

From: Dale Hall, Managing Director of Research, Society of Actuaries (SOA)
Leon Langlitz, Chair, SOA Committee on Life Insurance Company Expenses (CLICE)

Re: 2017 Generally Recognized Expense Table (GRET) – SOA 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 2017 GRET analysis for use with individual life insurance sales illustrations. Our analysis is based on expense and expense related information reported on companies' 2014 and 2015 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 2017. This memo describes our analysis and resulting findings.

NAIC staff provided Annual Statement data for life insurance companies for calendar years 2014 and 2015. This included data from 763 companies in 2014 and 744 companies in 2015. The primary reason for the lower number of companies in 2015 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 relatively small 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, 381 passed the outlier exclusion tests and were included as a base for the GRET factors (338 companies passed similar tests last year).

Approach used

The methodology we followed for calculating recommended GRET factors based on this data is similar in broad outline to that followed last year -- see our memo dated July 30, 2015 for a description of those changes.

To calculate updated GRET factors, the average of the factors from the two most recent years (2014 and 2015 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 (the seeds for all distribution channel categories are the same), as given in Appendix B, were used to compute total expected expenses. 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 categorized by their reported distribution channel (four categories were used, described in Appendix A of this memo). There remain a significant number of companies for which no distribution channel was available, as no responses to our annual surveys have been received from those companies. The characteristics of these companies vary significantly, including companies not currently writing new business or whose major line of business is not individual life insurance. 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.

Prior to 2014, when responding to the survey if a company indicated that they used multiple channels to distribute their individual life sales, the 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. This approach was not used in this analysis (or last year's) 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.

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 and non-tax expenses were less than $50,000 in either of the two years, for which their ratios were not deemed credible, or (3) they are reinsurance companies. 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.

The recommendation

Employing the above methodology results in the proposed 2017 GRET values shown in Table 1. To facilitate comparisons, the current 2016 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 the average face amount ($000s) per policy issued.

TABLE 1
PROPOSED 2017 GRET FACTORS, based on average of 2014/2015 data

Distribution Channel	Acquisition per Policy	Acquisition per Face Amount ($000)	Acquisition per Premium	Maintenance per Policy	Companies Included*	Average 1st Year Premium per Policy Issued During Year	Average Face Amount ($000) per Policy Issued During Year
Independent	$ 154	$ 0.80	38%	$ 46	128	$ 4,607	$ 249
Career	233	1.30	58	70	74	2,332	208
Direct	198	1.10	50	60	21	2,778	178
Niche	128	0.70	32	38	23	658	913
Other*	155	0.90	39	47	135	1,588	209
Total					381		

*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.

TABLE 2
CURRENT (2016) FACTORS, based on average of 2013/2014 data

Distribution Channel	Acquisition per Policy	Acquisition per Face Amount ($000)	Acquisition per Premium	Maintenance per Policy	Companies Included
Independent	$ 149	$ 0.80	37%	$ 45	115
Career	224	1.20	56	67	76
Direct	178	1.00	44	53	19
Niche	135	0.70	34	40	19
Other	153	0.80	38	46	109
Total					338

In previous recommendations, an effort was made to reduce volatility in the GRET factors from year-to-year by limiting the change in GRET factors between years to about ten percent of the prior value. The changes from the 2016 GRET were reviewed to ensure that a significant change was not made in this year's GRET recommendation. Only the Direct distribution channel category experienced a change greater than five percent from the corresponding 2016 GRET values for Acquisition per Policy expenses; primarily due to the change in the relatively small number of companies in this category.

Usage of the GRET

Also asked in this year's survey, responded to by companies' Annual Statement correspondent, was a question regarding whether the 2015 GRET table was used by the company. Last year, 25% of the responders indicated that the company used the GRET for sales illustration purposes, with similar percentage results by size of company; this contrasted with about 30% in the prior year. This year, 26.% of responding companies indicated that they used the GRET in 2015 for sales illustration purposes, with similar results for each of the distribution channels with a significant number of responders. We believe that, in addition, the variation in the results over the last three years in GRET use is in large part due to the relatively small sample size and different responders in these two surveys.

We hope LATF finds this information helpful and sufficient for consideration of a potential update to the GRET. If you require further analysis or have questions, please contact Dale Hall at 847-273-8835.

Kindest personal regards,

Dale Hall, FSA, MAAA, CERA
Managing Director of Research
Society of Actuaries

Leon Langlitz, FSA, MAAA, FLMI
Chair, Society of Actuaries'
Committee on Life Insurance Company Expenses

Appendix A -- Distribution Channels

The following is a description of distribution channels used in the development of recommended 2017 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 with no response (to this survey and prior surveys) and to indicate whether their exclusion has introduced a bias into the resulting values.

Appendix B – Unit Expense Seeds

The expense seeds used in the 2014 and prior GRETs were differentiated between branch office and all other categories, due to the results of a relatively old study that had indicated that branch office acquisition cost expressed on a per Face Amount basis was about double that of other distribution channels. Due to the elimination of the branch office category in the 2015 GRET, non-differentiated unit expense seeds have been used in the current and immediately prior studies.

The unit expense seeds used in the 2016 GRET and the 2017 GRET recommendation were 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 these two types of coverage, the unit expense seed was derived by judgment based this information. The following shows the averages derived from the Annual SOA studies and the seeds used in this study.

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

Current unit expense seeds:

	Acquisition/ Policy	Acquisition/ Face Amount	Acquisition/ Premium	Maintenance/ Policy
All distribution channels	$ 200	$ 1.10	50%	$ 60