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# NEWS AND NOTES

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With cash flow testing winding down, we can catch our breath and consider what the balance of 2011 promises. The forecast is for more regulation. There are developments in the areas of Risk-Based Capital (RBC), annuity suitability, and, for the New York market, commission disclosure.

## Year End 2010

As the rookie and an outside observer (who promises never to write from this viewpoint again) I was very impressed by the effort, competence, and organization that accomplished so much so quickly. Asset Adequacy Analysis was accomplished for 19 societies and 3 commercial companies. Valuation Reports and Memoranda, Regulatory Asset Adequacy Issues Summaries, RBC cash flow testing, and many ancillary reports were prepared for each. Sensitivity to higher mortality, lapses, and expenses was tested. Additional analysis (such as higher defaults) and reports were prepared for 11 New York-licensed clients and a few more still for California-licensed clients. Policy reserve summaries were prepared and reviewed as were some pension plan reserves. In the Pittsburgh office, ten complete Annual Statements were prepared and assistance was provided on six others. They also completed twelve Risk Based Capital Reports and eight New York Supplements. We are grateful to the many societies who sent us accurate in-force and investment data soon after third quarter 2010. That early start makes the timely end result possible.

## Valuation Interest Rates

Since our last client letter in January, there has been an uptick in Moody's Bond average rates. The 2012 life insurance valuation rate is still most likely to remain unchanged at 4% but the 2011 Single Premium Immediate Annuity (SPIA) valuation rate may be 5% if rates continue at their current higher level. That is down from 5.25% in 2010 but up from our last 4.75% prognostication for 2011. Five percent would be a very high guaranteed rate for SPIAs given current investment opportunities but it would not entail extra reserves. The final rates will become available in July.

More of our clients are quoting and issuing SPIAs. Some of those deferred annuities that we've sold for years actually do get annuitized and become retirement income. We can expect more of this as the boomers retire. The SPIA valuation interest rate is higher than a deferred annuity rate because there is no cash value after annuitization. We are also helping many of our clients develop and file deferred annuities with Minimum Guaranteed Interest Rate Redetermination. The interest rate guaranteed over the life of the annuity may be between 1% and 3% depending on rates available (an index) at the time of issue.

Risk-Based Capital

The NAIC has exposed a new draft of an RBC standard for fraternal societies. There are other regulators would who prefer to just use the commercial company formula. The main proposed change for all insurers is an increase in the Trend Test level. The regulatory RBC ratio is the "Total adjusted capital" divided by the "Authorized Control Level RBC". If this ratio is less than 300% (currently 250%) and it has declined over the last 3 years or one year, the greater annual decline is assumed to occur again next year. If applying that percentage decline results in less than a 190% RBC ratio, then a Fraternal Action Level RBC Plan is required. (This was previously called a Company Action Level RBC Plan.) The NAIC will do more on this topic in 2011 and some changes will require state action by either their legislature or their department of insurance. Stay tuned.

We realize some of our clients have more than adequate surplus and have had the privilege of largely ignoring these RBC issues. Others have had problems with state DOI and difficult discussions about the adequacy of surplus, even while growing and writing profitable business. For all, maintaining adequate surplus, as determined by RBC ratios, will become a way of life. Maintaining adequate surplus is just another expense of doing business. The commercial companies have lived with this reality for years. They have developed common tools for incorporating surplus considerations into their thinking from planning to pricing.

We will be discussing how to do that at the FSGP (Fraternal Societies of Greater Pittsburgh) Seminar May 19 and 20.

Annuity Suitability

The NAIC has adopted (2010) a new annuity suitability model bill strengthening the current model. A few states (IA, RI, CO, DC, OR, and NY) have already adopted it and many more are expected to follow in 2011. Some of its requirements:

1. The agent must have 4 hours continuing education on the subject of annuity suitability.
2. The agent must request information from the applicant concerning his: "*Age, Annual income, Financial situation and needs, including the financial resources used for the funding of the annuity, Financial experience, Financial objectives, Intended use of the annuity, Financial time horizon, Existing assets, including investment and life insurance holdings, Liquidity needs, Liquid net worth, Risk tolerance, and Tax Status*."
3. The agent must consider those 12 items in developing his recommendation to the client.
4. The agent must document his recommendation and maintain records of such recommendations.
5. The company must review the recommendation prior to contract issue.
6. The company is responsible for supervising this process and annually preparing a report on its effectiveness.

And those are just some highlights. Most clients may expect this to be passed in some of their states during 2011. You should prepare for it now. This will also be a topic at the May Seminar.

New York Commission Disclosure

Since 1/1/2011, NY has had a commission disclosure law for all sales. This may have caught some by surprise but we are aware of some clients who are helping their agents comply now. The law requires the agent to inform his client that he receives a commission and that the commission varies with the amount of the sale and the type of product sold. He must offer to tell the client the commission. If requested to tell the commission, he may state the initial commission in dollars or as a percentage of premium. Alternatively, he may state an average commission he will receive over the expected life of the policy. We can calculate those averages for you if you wish to give your agents that option. NY has suggested that they may not be so strict on enforcement the first six months. They do expect an effort towards compliance now and they will probably issue further regulations after observing the initial compliance.

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