

Bruce and Bruce Company

CONSULTING ACTUARIES

NEWSLETTER

April 2015

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Editor: Caroline Choi ASA, MAAA

CChoi@babco.us.com

(847) 295-6200

Bruce and Bruce Company

916 Sherwood Drive

Lake Bluff, IL 60044

www.bandbco.com

contact@babco.us.com

(847) 295-6200

(888) 278-2310

Bruce and DePersis

Suite 980

1910 Cochran Road

Pittsburgh, PA 15220

info@endepersis.com

(412) 343-7077

2014 Financial Experience- FSGP Group

By Robert E. Bruce

Data is still being collected for the 2014 financial experience, but some preliminary observations may be of interest.

Generally, profits increased by an average of 5% over 2013. The portfolio yields on an aggregate basis declined by a surprisingly small amount, while required payout rates remained constant. The average return for the entire group was 5.31%, with a required payout rate of 3.80%. The resulting spread, although slightly smaller than for 2013, resulted in increased profits. Aggregate asset volume increased 10%, with a similar increase in surplus. The capital ratios increased for 14 out of 24 reporting societies in the core group, although the aggregate declined slightly due to weighting for the larger Societies. Only 5 of the 34 reporting entities reported an operating loss in 2014, which is the same as for 2013. 2014 was, generally, a good year, rivaling 2013.

PBR Update: Small Company Exemption

In a memo issued to members on March 16, 2015, the NAIC provided details about the proposed small company exemption. If the proposal is adopted, an insurer will be exempt from Principles-Based Reserving (PBR) if it meets the following criteria:

- (1) The insurer's Ordinary Life Premiums must be less than \$300 million for the legal entity (insurer) and less than \$600 million for the associated group. Ordinary Life Premium consists of Ordinary Life Premium and Annuity Premium.
- (2) RBC Threshold: The insurer's RBC must be at least 450%.
- (3) Universal Life with Secondary Guarantees: There can be no material Universal Life with Secondary Guarantees business in force.
- (4) If an insurer is exempt from PBR, the reserve method must be CRVM.

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Own Risk and Solvency Assessment (ORSA) – Be Prepared!

We've been hearing a lot about ORSA lately. On the NAIC website, ORSA is described as *an internal process undertaken by an insurer or insurance group to assess the adequacy of its risk management and current and prospective solvency positions under normal and severe stress scenarios. An ORSA will require insurers to analyze all reasonably foreseeable and relevant material risks (i.e., underwriting, credit, market, operational, liquidity risks, etc.) that could have an impact on an insurer's ability to meet its policyholder obligations.*

So far, ORSA has been fully adopted by 20 states, including Illinois and Wisconsin. Although the ORSA regulation currently applies to individual US insurers who write more than \$500M of direct written and assumed premium and insurance groups that collectively write more than \$1B of annual direct written and assumed premium, it doesn't hurt to be prepared. If regulatory authorities find it useful, there may be attempts to apply ORSA to all insurers. Here are a few things you can do to prepare for the very likely event that your organization will be required to comply with ORSA in the future:

- 1. Understand the primary goals of ORSA and stay up to date with ORSA requirements and regulation**

It is important to note that ORSA has no prescribed format or calculation method. The goal is for companies to identify only those risks that are material and relevant.

- 2. Gather information**

Producing and retaining materials to evidence the efficacy of the Enterprise Risk Management (ERM) process for regulatory review is an essential part of ORSA. It's never too early to start collecting and reviewing existing ERM documentation. It may be a good idea to initiate discussions regarding ERM and interview key ERM stakeholders.

- 3. Get acquainted with the ORSA report**

There are three sections in an ORSA report:

Section 1: Description of Risk Management Framework (Qualitative)

Section 2: Assessment of Exposure (Quantitative)

Section 3: Group Risk Capital and Prospective Solvency Assessment

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List of States Adopting PBR (As of March 1, 2015)

In order for the Valuation Manual containing PBR to become operative, at least 42 jurisdictions (a supermajority) representing 75% of direct written premiums must adopt the revisions to the Standard Valuation Law. The List of States Adopting Principles-Based Reserving represents states that have enacted legislation by adopting the 2012 and 2013 amendments to the NAIC Standard Nonforfeiture Law for Life Insurance (Model No. 808) and/or the 2009 amendments to the NAIC Standard Valuation Law (Model No. 820). They are: *Arizona, Connecticut, Florida, Hawaii, Indiana, Iowa, Louisiana, Maine, Michigan, Mississippi, Nebraska, New Hampshire, New Jersey, New Mexico, Ohio, Oklahoma, Rhode Island, Tennessee, Texas, Virginia, and West Virginia.* That's a total of twenty-one states which have adopted PBR.

Valuation Interest Rates

The average of the Moody's Corporate Average Yield Rates (MCAYR) was 3.93% in February.

Life

The 2015 Life Reserve Rate is 3.50% and the Life Non-forfeiture Rate is 4.50%, the same rates as in 2014. If current market rates persist, there will be no change for 2016.

Immediate Annuities

The valuation rate for Immediate Annuities is likely to be reduced from 4.5% in 2014 to 4% in 2015.

For many companies, the 2015 Single Premium Immediate Annuities (SPIA) will be reserved on a new mortality table, the 2012 IAR. Both the lower interest rate and the new table suggest more conservative SPIA quotes. Bruce & Bruce Company will provide appropriate factors to use when quoting SPIAs for 2015 issue.

Deferred Annuities with Adjustable Guaranteed Minimum Interest Rate

For calendar year 2015, the minimum guaranteed interest rate allowed by the regulatory formula is 1%; the same rate as 2014. You can guarantee a higher rate and continue to credit a higher "current non-guaranteed rate".

2015 FSGP SEMINAR

Mark your Calendars!

Thursday, May 21st & Friday, May 22nd

Embassy Suites, Pittsburgh Airport

Thursday, May 21st

Registration 8:30 AM

Business Session 9:00 AM to 3:45 PM

Dinner 5:30 PM

Friday, May 22nd

Registration 8:30 AM

Round Table Discussion 9:00 AM - Noon

Tentative Agenda

1. 2014 Results and Emerging Issues
2. Investment Presentation
3. Fraternal Presentation
4. Insurance Department
5. Marketing Presentation
6. Fiduciary Responsibilities
7. Enterprise Risk Mgmt ORSA 2013
8. Important Industry Changes
9. American Fraternal Alliance (AFA) - Shared services with National Association of Mutual Insurance Companies (NAMIC)
10. Cyber Security

PBR Update: Small Company Exemption (Continued)

It is important to note that the exemption would apply to the entire company unlike the existing product line exclusions. Additionally, rather than being exempted from the Valuation Manual entirely (and thus not subject to reporting requirements, etc.), the insurer would be exempted from performing PBR exclusion tests.

For those insurers that would not be exempt, the proposed PBR (Principles-Based Reserving) framework has 3 types of reserve calculations (from the most advanced to the simplest):

- Stochastic Reserve
- Deterministic Reserve
- Net Premium Reserve

A product line can be exempt from stochastic modeling if it passes one of two tests: the Stochastic Exclusion Ratio Test or the Stochastic Exclusion Demonstration Test. If a product line is exempt from stochastic modeling, it would also be tested for exclusion from deterministic reserving using the Deterministic Exclusion Test.

Exceptions to 10% Penalty on Early Withdrawals from an IRA or Retirement Plan

Generally, the amounts an individual withdraws from an IRA or retirement plan before reaching age 59¹/₂ are called “early” or “premature” distributions. Individuals must pay an additional 10% early withdrawal tax and report the amount to the IRS for any early distributions, unless an exception applies. The distribution will NOT be subject to the 10% penalty in the following circumstances:

- **Age:** After the participant/IRA owner reaches age 59¹/₂
- **Death:** After death of the participant/IRA owner
- **Disability:** Total and permanent disability of the participant/IRA owner
- **Domestic Relations:** To an alternate payee under a Qualified Domestic Relations Order
- **Education¹:** Qualified higher education expenses
- **Equal Payments:** Series of substantially equal payments. Based on one of the IRS Life Expectancy methods, the series of payments must continue for the longer of 5 years or until the individual reaches age 59¹/₂.
- **Homebuyers¹:** Qualified first-time homebuyers, up to \$10,000
- **Levy:** Because of an IRS levy of the plan
- **Medical:** Amount of unreimbursed medical expenses (>7.5% AGI; after 2012, 10% if under age 65)
- **Military:** Certain distributions to qualified military reservists called to active duty
- **Rollovers²:** In-plan Roth rollovers or eligible distributions contributed to another retirement plan or IRA within 60 days
- **Separation from Service³:** The employee separates from service during or after the year the employee reaches age 55 (age 50 for public safety employees in a governmental defined benefit plan)

¹ Not applicable to Qualified Plans such as 401(k)

² Limited to one per year

³ Applicable only to Qualified Plans such as 401(k)

Own Risk and Solvency Assessment (ORSA) – Be Prepared! (Continued)

The following resources are available on the NAIC website and are very helpful in understanding ORSA:

- NAIC ORSA Guidance Manual
http://www.naic.org/store/free/ORSA_manual.pdf
- 2012-2013 ORSA Pilot Feedback
http://www.naic.org/store/free/ORSA_manual.pdf