Bruce and Bruce Company

CONSULTING ACTUARIES

NEWSLETTER

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INSIDE THIS ISSUE

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This has been a busy and exciting summer for everyone at Bruce & Bruce Company! Our staff has been working hard wrapping up the year-end work. As five of our clients have been going through state examinations, our valuation actuaries have never had a dull moment. The state exams have been re-designed to put more focus on risk management, and this new "risk-focused" approach seems to have generated an unusually high volume of requests from examiners.

To better serve the future needs of our clients, we have started using AXIS, an actuarial software that will enhance our future capabilities. AXIS will help us improve processes in our specialty areas: cash flow testing, projection, illustration testing, and profit study. AXIS will also allow us to meet Principles-Based Reserving requirements, should they eventually be adopted.

Bruce & Bruce Company is expanding! This summer, Caroline Choi has joined our team as Associate Actuary. Caroline is an Associate of the Society of Actuaries and a Member of the American Academy of Actuaries. That brings us up to sixteen employees including six members of the American Academy of Actuaries.

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Valuation Interest Rates

The Moody's bond index for July 2014 is 4.37% -- down 7 basis points from June's rate.

The 2015 Life Reserve Rate will remain at **3.50%** and the Life Nonforfeiture Rate will remain at **4.50%**.

The Single Premium Immediate Annuity reserve interest rate will be **4.50%** maximum for 2014 sales up from 4% in 2013.

The Deferred Annuity reserve interest rate will continue at **3.50%** for 2014 FPDA and SPDA sales.

The new adjustable minimum rate for annuity non-forfeiture remains firmly stuck at **1%**.

A Risk-Based Capital Analogy

Fraternal societies have been living with RBC for a few years now. Results and understanding are improving. However, misunderstanding persists as both the concept and the calculations are somewhat complex. One society has a consistent record of profitability but a weaker RBC ratio. Another society has weak sales and profits but a better RBC ratio. Is RBC missing something? What does it measure if it doesn't even reflect growth or profits?

It is just an index intended to reflect surplus relative to risk-taking.

When I was a kid I was a bit of a risk taker. I showed that by climbing higher in the tree and going farther out on a limb than my friends. If there had been an index for my risk taking it might have looked like the RBC formula! The square root of the sum of the squares (of height and limb length) would indicate the distance I had gotten from the origin (base of the tree trunk). Of course, climbing 20 feet up and going ten feet out on a limb is safer in a 100 year old Live Oak than in a five year old soft maple. To reflect how much the strength of the tree supported my risk-taking, we could divide the diameter of the branch (inches) where I sat by the distance (in yards). By moving the risk calculation to the denominator we get more of a safety index than a risk index.

Could such a safety index be useful? My parents could have developed some useful guidelines. If the index exceeded 500%, they could have taken my picture and applauded my skill and daring. If the index was between 300% and 500% they could have cautioned me about climbing higher or going further out on the limb. Between 200% and 300% they might have asked how I intended to get down and suggested a safe route. Under 200% they might have called the fire department or paramedics. Note that this risk-taking index doesn't reflect my grades in school or my annual physical exam results. I never had a bad fall. If I had, it might have affected my grades and annual physical exam. I took some risk and got away with it.

The analogy should be obvious but just in case: I was the fraternal society, the height and length represented my insurance and investment risks, the limb diameter represented the surplus supporting me. And my loving parents represented the regulators.

Neither the tree climbing index nor the RBC index is perfect. But they do reflect who is, relatively speaking, higher up in the tree, farther out on a limb, and sitting on a thinner branch. All societies are in the business of taking risk. A larger society or company can refine its risk analysis and risk management (ORSA). For those that lack the resources to do this, maintaining an average RBC ratio will indicate that the financial results are not achieved by undue risk-taking.

By Grant Hemphill

2012 IAR Table

In many states, the 2012 Individual Annuity Reserving (2012 IAR) Table will replace the Annuity 2000 Mortality (a2000) Table as the valuation standards for new issues on January 1, 2015. The state of domicile controls what a society should do. IL, NJ, and IN will have adopted the new table by January 1, 2015. PA and OH have not taken any action on the NAIC model bill.

2012 IAR is a generational table that incorporates projections for future mortality improvements. Thus reserves will generally increase for most ages. On the flip side, your SPIA or supplementary contract quote (for a given issue age) should decline each year in the future.

We suggest removing the table of settlement options the next time you revise your life and annuity contracts. These are not required as long as the mortality basis is set forth in the contract. (Florida may be an exception.) Illustration and valuation systems, both for deferred and payout annuities, must be updated to reflect the 2012 IAR Table.

In-Force Clean Up

In the current regulatory environment it is a good time to consider cleaning up in force records. States are looking for matured policies or policies whose insured is deceased. Actuaries often notice some matured policies (and so do the states' actuaries) in reserve runs. When policies exceed the maximum mortality table age or the endowment duration, the reserve is manually set equal to the face amount. This is an indicator that you have matured polices in your in force and that you might be a good candidate for a death claims master file audit.