



SOCIETY OF ACTUARIES

July 30, 2013

To: Reggie Mazyck, NAIC

From: Steven Siegel
Society of Actuaries (SOA) Research Actuary

cc: Sam Gutterman, Tim Harris co-chairs, SOA Committee on Life Insurance Company Expenses (CLICE)

Re: SOA 2014 Generally Recognized Expense Table (GRET) Analysis

As in previous years, the Society of Actuaries expresses its thanks to the NAIC for its help and responsiveness in providing Annual Statement expense and unit data for our 2014 GRET Analysis for use with individual life insurance sales illustrations (based on expense and expense related information reported on companies' 2011 and 2012 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 2014. This memo describes our analysis and resulting findings.

NAIC staff provided Annual Statement data by life insurance company for calendar years 2011 and 2012. This included data from 808 companies in 2011 and 788 companies in 2012. The primary reason for the lower number of companies in 2012 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 difference in number of companies between years is consistent with prior experience with this data. Because we subsequently excluded certain companies' experience because of outlier and reinsurance exclusion tests, the absence of these late reporting companies is not expected to significantly affect the results. Of the total companies, 277 passed the outlier and reinsurance exclusion tests and were included as a base for the GRET factors.

The methodology we followed for calculating GRET factors based on this data is similar to that followed last year. Please refer to the submission for the previous year for a more complete description of the overall process followed. The overall approach reflects the percentage of business written by each distribution channel category (see the appendix for the definitions used, the same as was used last year; for example, if 50% of a company's business was derived from category A and 50% was from category B, 50% of that company's factors was used to obtain the average of the factors for both category A and category B). Note that each company's aggregate values were used for each category, as channel-specific expenses and units are not available. Of the 277 companies included in the 2011 and 2012 results, 48 companies indicated that they had written business through more than one distribution channel.



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To calculate updated GRET factors, the average of the factors from the two most recent years (2011 and 2012) of Annual Statement data was used. For each company an actual to expected ratio was calculated. Seed factors derived from a previous LOMA expense study were used to compute expected expenses (note that the seeds for all categories other than Branch Office are the same). These seed factors were used to allocate expenses between acquisition and maintenance expenses and among the three acquisition expense factors. Companies were excluded from the analysis if their actual to expected ratios were considered outliers, often due to low business volume or having a relatively large amount of ceded reinsurance. 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 the tables.

In an effort to reduce volatility in the factors, two additional steps are included in the methodology. First, only companies that passed all outlier tests for *both* 2011 and 2012 are included in the averages in the following tables; that is, the same set of companies for 2011 and 2012 are used for each category. Companies that pass the outlier tests represent 47% of industry first year individual life premium. Secondly, a limit of plus or minus ten percent (before rounding) has been imposed on any change in GRET factors from the prior year. This year, this limitation was applied for the Branch Office, Direct Marketing, PPGA, and Other categories. Without this limitation, the factor changes would be approximately 29%, -18%, -20%, and 12%, respectively.

Employing this methodology results in the proposed 2014 GRET values as shown in Table 1. The current 2013 GRET factors and the percentage change represented by each proposed factor are shown in Table 2.

Further characteristics of the type of companies represented in each category are included in Table 1, including the average premium per policy issued and average face amount (\$000s) per policy issued.

**TABLE 1
PROPOSED 2014 GRET FACTORS, based on average of 2011/2012 data**

Distribution Channel	Acquisition per Policy	Acquisition per Face Amount (\$000)	Acquisition per Prem	Maintenance per Policy	Company Count*	Average Premium per Policy Issued During Year	Average Face Amount (\$000) per Policy Issued During Year
Branch Office	\$ 73	\$ 1.30	80%	\$ 36	22	\$ 4,722	\$ 336
Direct Marketing	74	1.40	41	37	31	437	23
Home Service	77	1.40	42	38	10	852	24
Career General Agency	91	1.60	50	46	32	1,661	127
Brokerage	85	1.50	47	42	33	4,360	172
PPGA	91	1.60	50	46	56	2,263	102
Multiline	144	2.60	79	72	16	1,124	153
Other	99	1.80	54	50	77	1,307	62
Total					277		



TABLE 2
Current 2013 Factors

Distribution Channel	Acquisition per Policy	Acquisition per Face Amount (\$000)	Acquisition per Prem	Maintenance per Policy
Branch Office	\$ 66	\$ 1.20	73%	\$ 33
Direct Marketing	82	1.50	45	41
Home Service	86	1.50	47	44
Career General Agency	96	1.70	53	48
Brokerage	96	1.70	53	48
PPGA	101	1.80	56	51
Multiline	141	2.50	78	71
Other	90	1.60	49	45

TABLE 3
Percent Change between the proposed 2014 and current 2013 factors

Distribution Channel	Acquisition per Policy	Acquisition per Face Amount (\$000)	Acquisition per Prem	Maintenance per Policy
Branch Office	11%	8%	10%	9%
Direct Marketing	-10	-7	-9	-10
Home Service	-10	-7	-10	-14
Career General Agency	-5	-6	-5	-4
Brokerage	-11	-12	-12	-13
PPGA	-10	-11	-11	-10
Multiline	2	4	2	1
Other	10	13	10	11

A question raised by LATF in 2012 was the prevalence of use of the GRET table by life companies. To gauge this prevalence, a question was added to the survey of companies (including a follow-up with non-responders of the initial information request) in which we asked the Annual Statement correspondent to confirm with the company’s illustration actuary seeking company usage of the GRET in 2012. Of the companies that wrote any individual life new business during 2012 that responded to the survey with a yes or no response to the question of whether they used the GRET in 2012 for sales illustration purposes, 20% responded indicating they used the GRET (30 out of 152). This percentage was relatively consistent by size and distribution channel:

- By size of first year individual life premium. 20%, 17 of 85 small companies (less than \$10 million), 20%, 17 of 85 medium size companies (between \$10 million and \$100 million) and 17%, 4 of 23 large companies (more than \$100 million).
- By distribution channel category. 2 out of 11 branch office companies, 2 of 9 direct marketing companies, 2 of 7 home service companies, 7 of 24 career general agent



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companies, 6 of 31 brokerage companies, 7 of 37 PPGA companies, 2 of 13 Multiline companies and 2 of 20 not otherwise categorized companies.

This year's survey reduced the number of those in the "other" distribution channel category from 89 to 77; efforts will continue next year to further reduce this number. We did not complete a bottom-up reassessment of the seed used for calculation of the GRET factors this year. We intend to pursue this assessment next year. We also intend to revisit the definitions of distribution channel shown in the appendix to this memo next year – the current categories are the ones we use for our annual inter-company expense experience study.

We hope you find this information helpful and sufficient for LATF's consideration of potential update to the GRET.

If you require further analysis or have questions, please contact me at 847-706-3578.

Sincerely,

Steven Siegel
Society of Actuaries Research Actuary



Appendix -- Distribution channels

The following is a description of distribution channels used in the development of GRET values:

- **Branch Office** - A company or division which operates an agency building system featuring field management that are employees although their compensation may be largely based on production. The company provides significant employee benefits to field employees in addition to direct compensation.
- **Direct Marketing** - A company or division that markets directly to the public through printed or other media. No direct field compensation is involved.
- **Home Service** - A company or division that markets smaller insurance policies through an organization that resembles the Branch Office system in organizational and compensation structure but focuses on smaller policies and agent collections of premiums. Note that this request focuses only on the distribution of ordinary life business, not considering any industrial business written by a company.
- **Career General Agency** - An agency-building system using full-time agents who report to managers who are company employees or general agents who are independent contractors.
- **Brokerage** - A system that uses independent producers (brokers) who are contracted with multiple companies. The bulk of their income comes from overrides rather than personal production. This includes managing general agents and independent marketing organizations.
- **PPGA** - A system that uses independent personal producing general agents (PPGAs) who are often contracted with multiple companies. The bulk of their income comes from personal production rather than overrides.
- **Multi-Line** - A system that uses full-time agents licensed to write property-casualty, life, health, annuities, and equity products and who primarily represent one company.
- **Other** - Companies or divisions other than those described above. If you choose this category, please provide a brief description of the distribution system for your company's ordinary life business.