7/20/11

The NAIC solicits comments on this draft. Comments should be sent to John Engelhardt, NAIC, at JEngelha@naic.org by August 22, 2011.

SOCIETY OF ACTUARIES

June 10, 2011

To: John Engelhardt, 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 2012 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 data for our 2012 GRET Analysis for use with individual life insurance sales illustrations (based on expense and expense related information reported on companies' 2009 and 2010 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 2012. This memo describes our analysis and resulting calculations. For definitions of certain terms, please refer to our previous GRET analyses available on the NAIC website.

NAIC staff provided Annual Statement data by life insurance company for calendar years 2009 and 2010. This included data from 854 companies in 2009 and 827 companies in 2010. The primary reason for the lower number of companies in 2010 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 is consistent with prior experience with this data. In any event, because of the outlier and reinsurance exclusion tests applied, the absence of these late reporting companies is not expected to significantly affect the results. Of the 827 companies, 288 passed the outlier and reinsurance exclusion tests in 2010 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 in the past several years, with exceptions noted below. Please refer to submissions for the previous years for a more complete description of the overall process followed. The most significant differences this year resulted from:

(1) A two stage survey of information regarding the distribution channels from each company that passed our criteria in order to increase the number of companies for which we have distribution channel information. The second request included a quote from the chair of LATF encouraging submission. This additional survey was issued in an attempt to reduce the number of companies that were included in the 'other' distribution channel category. This reduced the number of companies in the 'other' category from 124 (out of 299 in 2009) to 118 (out of 288 in 2010).
(2) Inclusion of two alternative approaches to reflect data for companies that use multiple distribution channels (of the 276 survey responses, 67 companies indicated that they had more than one distribution channel in 2010). This was undertaken, at the request of LATF, to better reflect the effect of unit expenses of companies that employ multiple distribution channels. Please see the letter from the Committee on Life Insurance Company Expenses (CLICE) to John Engelhardt dated December 17, 2010 with the caption "Proposed approach to reflect multi-channel distribution system expenses for the Generally Recognized Expense Table (GRET)" for further background information on this request.

The two approaches taken to evaluate multiple distribution channels were:

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1. As in last year's submission, each company was assigned a single distribution channel category from a list of eight options (listed below) that has been used for the last five years. Companies that indicated that they used multiple distribution systems during 2010 in their survey response were placed into the category that represented the greatest portion of their overall business.
2. The percentage of business attributed to each of the eight distribution channel categories was applied to the company's factors. 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 in obtaining the average of the factors for both category A and category B.

In theory, approach 2 should somewhat better reflect the actual distribution channel's expenses in that it adjusts for the relative weight of a company in each distribution channel. Of course, a more refined approach would incorporate actual expenses and their corresponding expenses for each distribution channel. However, as we have found in our annual inter-company expense study, it can be difficult to develop accurate data for some of the companies with multiple distribution channels. **We recommend that the refinement in methodology incorporated in approach 2 be used for the final 2012 GRET factors.** As can be seen, the use of approach 2 did not make a significant difference in the final GRET factors -- in large part this is due to the relatively limited variations in the factors by distribution channel.

The distribution channel categories used follow:

- 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.

In order to calculate updated GRET factors, the average of the two most recent years (2009 and 2010) of Annual Statement data was used. For each company an actual to expected ratio is calculated. Seed factors derived from a previous LOMA expense study are 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 are excluded from the analysis if their actual to expected ratios are considered outliers, often due to low business volume or they have 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 is calculated. The resulting factors are rounded as shown in the tables.

In an effort to reduce volatility in the results, two additional steps are included in the methodology, identical to what has been used in the development of the last two GRET factor recommendations. First, only companies that passed all outlier tests for *both* 2009 and 2010 are included in the averages; that is, the same set of companies for 2009 and 2010 are used for all categories. Companies that pass the outlier tests represent 53.0% of industry first year premium. Secondly, a limit of plus or minus 10% (before rounding) has been imposed on any change in GRET factors from the prior year. This year, this limitation was applied for the Direct Marketing and Home Service categories. Without this limitation, the factor changes for Direct Marketing and Home Service would be approximately -19% and 35%, respectively.

Employing this methodology results in the proposed 2012 GRET values, as shown in Table 1 below. Corresponding values using the prior approach (relying on the primary distribution channel rather than percentage of distribution channels) are shown in Table 2. The current 2011 GRET factors and the percentage change represented by each proposed factor are shown in Table 3.

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 2012 GRET FACTORS, based on average of 2009/2010 data and recommended approach (2)

Distribution Channel	Acquisition Per Policy	Acquisition Per Unit	Acquisition Per Prem	Maintenance Per Policy	Company Count*	Average Premium Per Policy Issued During Year	Average Face Amount Per Policy Issued During Year
Branch Office	64	1.10	0.71	32	19	$ 4,494	$ 379
Direct Marketing	80	1.40	0.45	41	16	901	38
Home Service	78	1.40	0.43	40	13	615	14
Career General Agency	101	1.80	0.55	50	31	2,150	157
Brokerage	98	1.70	0.54	49	25	7,506	257
PPGA	92	1.60	0.51	46	47	1,944	102
Multiline	127	2.30	0.70	64	19	1,154	155
Other	85	1.50	0.47	42	118	1,798	79
Total					288		

Table 2
2012 GRET Factors, based on average of 2009/2010 data and prior approach (1)

Distribution Channel	Acquisition Per Policy	Acquisition Per Unit	Acquisition Per Prem	Maintenance Per Policy	Company Count*	Average Premium Per Policy Issued During Year	Average Face Amount Per Policy Issued During Year
Branch Office	61	1.10	0.67	30	19	$ 4,494	$ 379
Direct Marketing	80	1.40	0.45	41	16	901	38
Home Service	78	1.40	0.43	40	13	615	14
Career General Agency	102	1.80	0.56	51	31	2,150	157
Brokerage	97	1.70	0.54	49	25	7,506	257
PPGA	94	1.70	0.52	47	47	1,944	102
Multiline	128	2.30	0.71	64	19	1,154	155
Other	84	1.50	0.46	42	118	1,798	79
Total					288		

*tabulated based on the primary distribution channel of each company

Table 3
Current 2011 Factors (prior approach)

Distribution Channel	Acquisition Per Policy	Acquisition Per Unit	Acquisition Per Prem	Maintenance Per Policy
Branch Office	67	1.20	0.74	33
Direct Marketing	89	1.60	0.50	45
Home Service	71	1.30	0.39	36
Career General Agency	100	1.80	0.55	50
Brokerage	88	1.50	0.49	44
PPGA	89	1.60	0.49	45
Multiline	127	2.30	0.70	64
Other	76	1.40	0.42	38

Table 4
Percent Change between the proposed 2012 and current 2011 factors

Distribution Channel	Acquisition Per Policy	Acquisition Per Unit	Acquisition Per Prem	Maintenance Per Policy
Branch Office	- 4%	- 8%	- 4%	- 3%
Direct Marketing	- 10	- 13	- 10	- 9
Home Service	10	8	10	11
Career General Agency	1	0	0	0
Brokerage	11	13	10	11
PPGA	3	0	4	2
Multiline	0	0	0	0
Other	12	7	12	11

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

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

Sincerely,

Steven Siegel
Society of Actuaries Research Actuary

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