

ALLIANCE WEBINAR

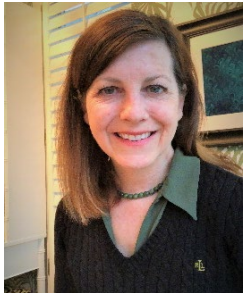
***Emerging Changes to Valuation
and Nonforfeiture Interest Rates
for January 1, 2021***

*Please stand
by...*



ALLIANCE WEBINAR

Emerging Changes to Valuation and Nonforfeiture Interest Rates for January 1, 2021



Allison Koppel
Alliance Chief Operations Officer



SPEAKERS

Emerging Changes to Valuation and Nonforfeiture Interest Rates for January 1, 2021



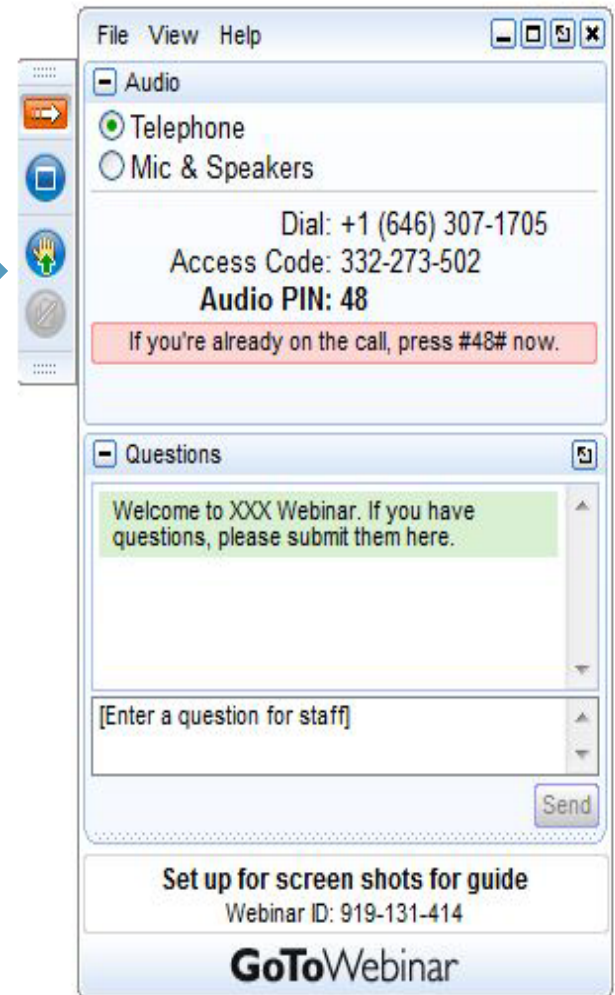
Brad Simanek, FSA, MAAA
Griffith, Ballard & Company



Austin Swanson, FSA, CERA, MAAA
Griffith, Ballard & Company



Participate by “raising your hand”



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Upcoming Challenges for Fraternal Benefit Societies Posed by the Current Interest Rate Environment

September 23, 2020

Brad Simanek, FSA, MAAA
Austin Swanson, FSA, CERA, MAAA

Griffith, Ballard & Company
Consulting Actuaries

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Griffith, Ballard & Company

- Founded in 1916; oldest continuously-run actuarial consulting firm in the country
- Serving needs of Fraternal Benefit Societies for over a century



Brad Simanek, FSA, MAAA

- A.B., Dartmouth College (1993)
- M.B.A., The University of Chicago - Booth School of Business (1995)
- 25 years at Griffith, Ballard & Company (1995), co-owner since 2010
- Appointed & Illustration Actuary; management consulting; pricing; M&A

Austin Swanson, FSA, CERA, MAAA

- B.S., University of Iowa (2016)
- Joined Griffith, Ballard & Company in 2019
- Pricing; data management; internal audit



What to expect from this presentation:

- ✓ **recent history of key interest rate data**
 - U.S. Treasury (UST) Yield Curve
 - Moody's Corporate Average Yield Rate (MCAZR)
- ✓ **valuation/nonforfeiture rates**
- ✓ **regulatory and governmental actions**
 - NAIC Valuation Manual
 - HEROES/HEALS legislation
 - I.R.C. §7702 and §7702A
- ✓ **“ripple effect”**
 - premium levels/product profitability
 - solvency testing
 - risk-based capital (RBC)

In case you hadn't heard...

- **reserves** for new life issues starting **January 1, 2021**
 - **no greater than 3.0%** (currently 3.5%)
- **nonforfeiture values** for new life issues starting **January 1, 2022**
 - **no greater than 4.0%** (currently 4.5%)
- both apply to **virtually all life products**
 - e.g., traditional, > 20 years “guarantee duration”
- do not apply to products **issued on or before 12/31/2020**
 - i.e., not retroactive
- nonforfeiture rate **could be lower than 4.0%**

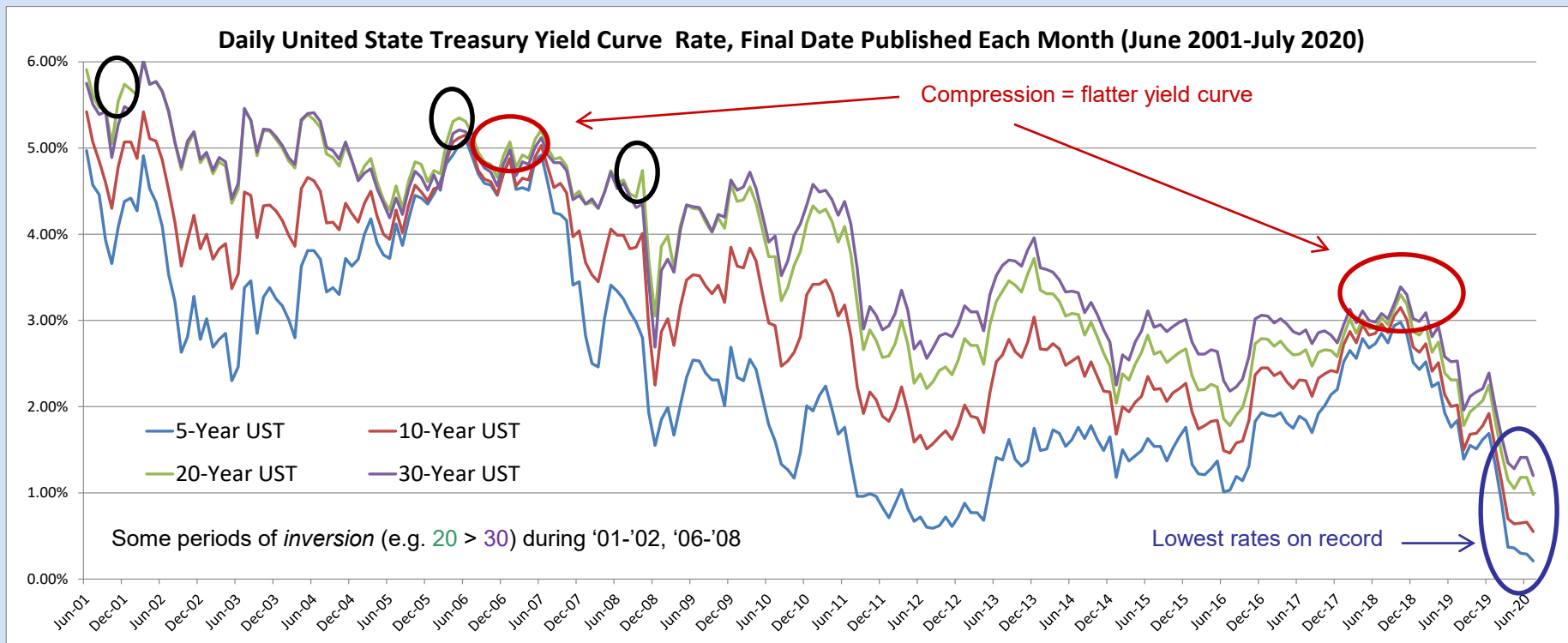
Changes require **attention, organization and action** for the near, intermediate, and longer term.

1. focus (Q4-2020) on January 1, 2021, needs first
2. January 1, 2022, requirements during 2021
→ systems updates and filing requirements
3. product pricing/profitability, solvency testing/RBC ratios
4. regulation and taxation/tax-treatment of insurance

So how did we get here?

Market interest rates declining for over two decades.

- comparable investment products
- excess operational dollars



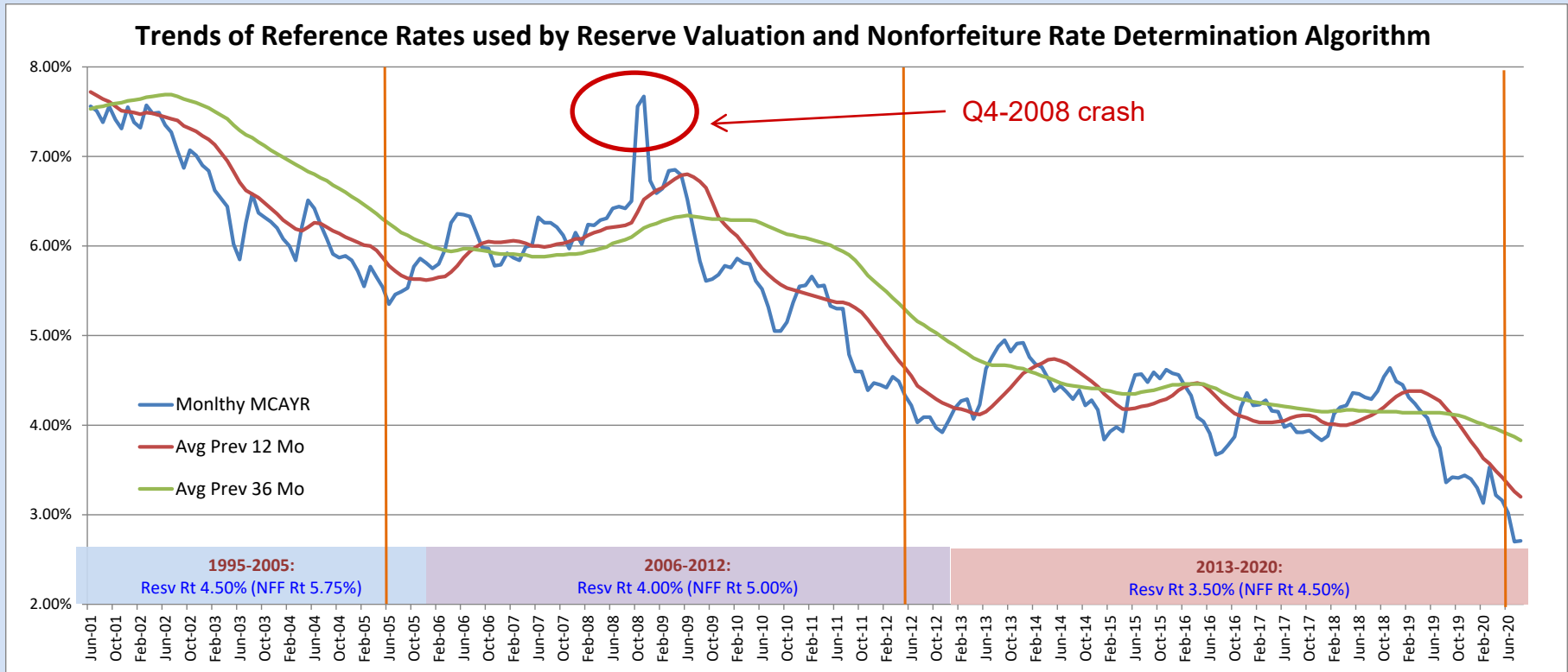
Life Insurance valuation and nonforfeiture discounting rates are driven by the **Moody's Corporate Average Yield Rate (MCAYR)**.

- composite yield on seasoned corporate bonds
- available via NAIC website (two months only)
- cited in VM-20 of NAIC Valuation Manual

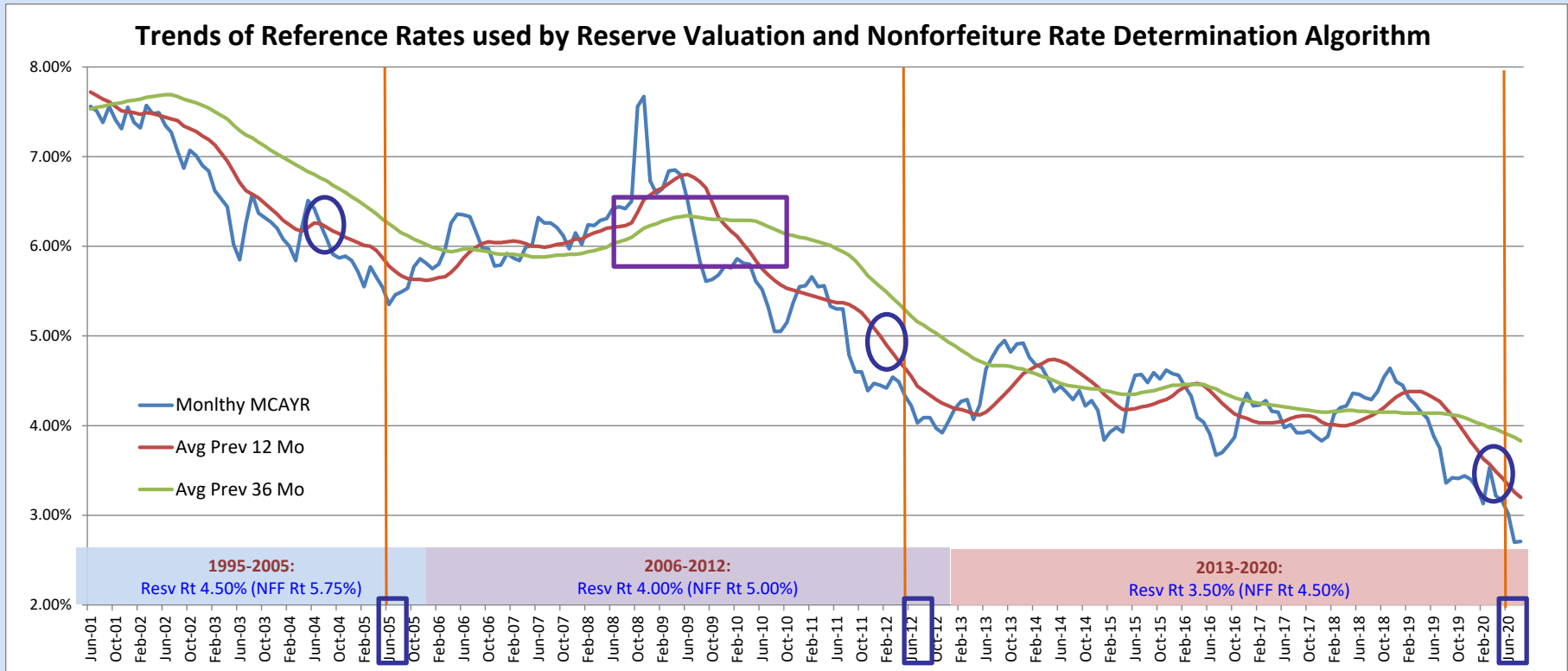
Formulas govern **maximum allowed discount rate for reserve calculation**, by calendar year of contract issue.

- *minimum* of **12**- and **36**-month moving averages
- values as of June 20xx determine valuation rate for calendar year 20xx+1
- valuation rate changes in 0.5% increments

Similarly, **maximum allowed discount rate used for calculating corresponding nonforfeiture (cash) values** are based on life reserve valuation rate (VM-02).



MCAJR has also been trending downward for two decades—
“Great Recession” only delayed inevitable changes (2012
and 2020).



Based on VM methodology, trigger-points already known:

- Aug 2004 **A12** fell/stayed < **6.215%** → Val Rate on 1/1/2006 = 4.0% (NF Rate = 5.00%)
- Apr 2012 **A12** fell/stayed < **4.786%** → Val Rate on 1/1/2013 = 3.5% (NF Rate = 4.50%)
- Jun 2020 **A12** fell/stayed < **3.358%** → Val Rate on 1/1/2021 = 3.0% (NF Rate = 3.75%*)
- Rebound in 2009 not enough (**A36** & **A12** < **6.929%**) to return to 4.5% reserves (0.5% rule)

Latest change to life valuation rate (effective for 1/1/2021 issues) could last awhile.

- return to 3.5%? lower of **A12** and **A36** > **4.071%**
- drop to 2.5%? lower of **A12** and **A36** < **1.929%**
- ... **by June 20xx**, to affect 1/1/20xx+1 issues
- currently (Aug '20): **A12** = 3.20%; **A36** = 3.83%

Comment: VM-20/SVL equation not designed to handle reference rates below 3% (odd results).

→ algorithm revisions? likely clarification/clean-up only

Algorithm “does its job.”

- correlated with market environment
- built-in “damper”
- best interest of insurance buyers
 - internal growth rate (cash/nonforfeiture values)
in line with those of other investments

Challenge to insurers: addressing these regulation-forced changes...

- ... before end of the current calendar year
- ... facing limited flexibility in resources (financial, human capital)
- ... in the middle of a pandemic

But wait, there's more!

**Final determination of
new nonforfeiture rate remains unresolved.**

- valuation rate of 3.0% → nonforfeiture rate of 3.75%
- years 2020 and prior: NF rate “floored” at 4.0%
 - cash/NF values using 4.0% are *typically lower* than what 3.75% produces

But wait, there's more!

**Final determination of
new nonforfeiture rate remains unresolved.**

- NAIC re-defined 2021 VM-02 floor → I.R.C. §7702
- use Cash Value Accumulation Test (CVAT) ... currently 4.0%
- Congress considering revisions to I.R.C. §7702, changes CVAT rate → 3.75%-based nonforfeiture values

Here's what we know...

- Valuation rate (1/1/21+) changing from 3.5% to 3.0%
- *As of now*, nonforfeiture rate changing from 4.5% to 4.0%
 - may **defer NF changes up to one (1) year**
 - effective no later than for issues 1/1/22 and after
- House: *H.E.R.O.E.S.* Act (passed), contains I.R.C. §7702 changes
- Senate: *H.E.A.L.S.* Act (stalled), *no similar provisions*

In short, **unless** further action is taken and bills passed by both House and Senate include §7702 change provisions and President Trump signs into law, companies should plan for **what's stated above.**

Actions and timelines: RESERVE RATE CHANGES

Before EOY 2020, address reserve/valuation changes, for all existing (i.e., filed/ approved) plans expecting to issue in early 2021:

- **reserve value calculation** for all to-be-issued plans
- **operational systems** (valuation)

Project is manageable within timeframe, but crucial that companies **don't delay getting started**.

Actions and timelines: **NONFORFEITURE RATE CHANGES**

Much more work:

- **nonforfeiture value calculation** (to-be-issued, and not already on 4%)
- **illustration software** and **marketing materials** updates
- **compliance/filing requirements**
 - informational filing
 - policy text issues? (e.g., “table of values” not [bracketed])
 - *check your term plans!* (unwanted cash values could develop)
- **operational systems** (administrative, valuation, etc.)

Waiting/delaying implementation of this change into 2021 makes sense—particularly as **product repricing/ profitability analysis** may be in company’s interest.

Actions and timelines: **PRODUCT PROFITABILITY IMPACT**

Changes to pricing (premiums and/or dividends) desired?

- Reserves: timing/horizon of profit recognition
→ “deficiency” reserves (if non-PBR)
- Cash/nonforfeiture values: impact of persistency/surrender
- Dividend scales: based on/derived from reserves/NF values?
→ marketing/illustrations impacted?
- Investment earned rate assumption: new money rate?
portfolio subsidized?

Re-pricing **effort and other costs** (i.e., rate cards, systems changes, re-training) could be delayed until 2021, but not too soon to **test profitability impact**.

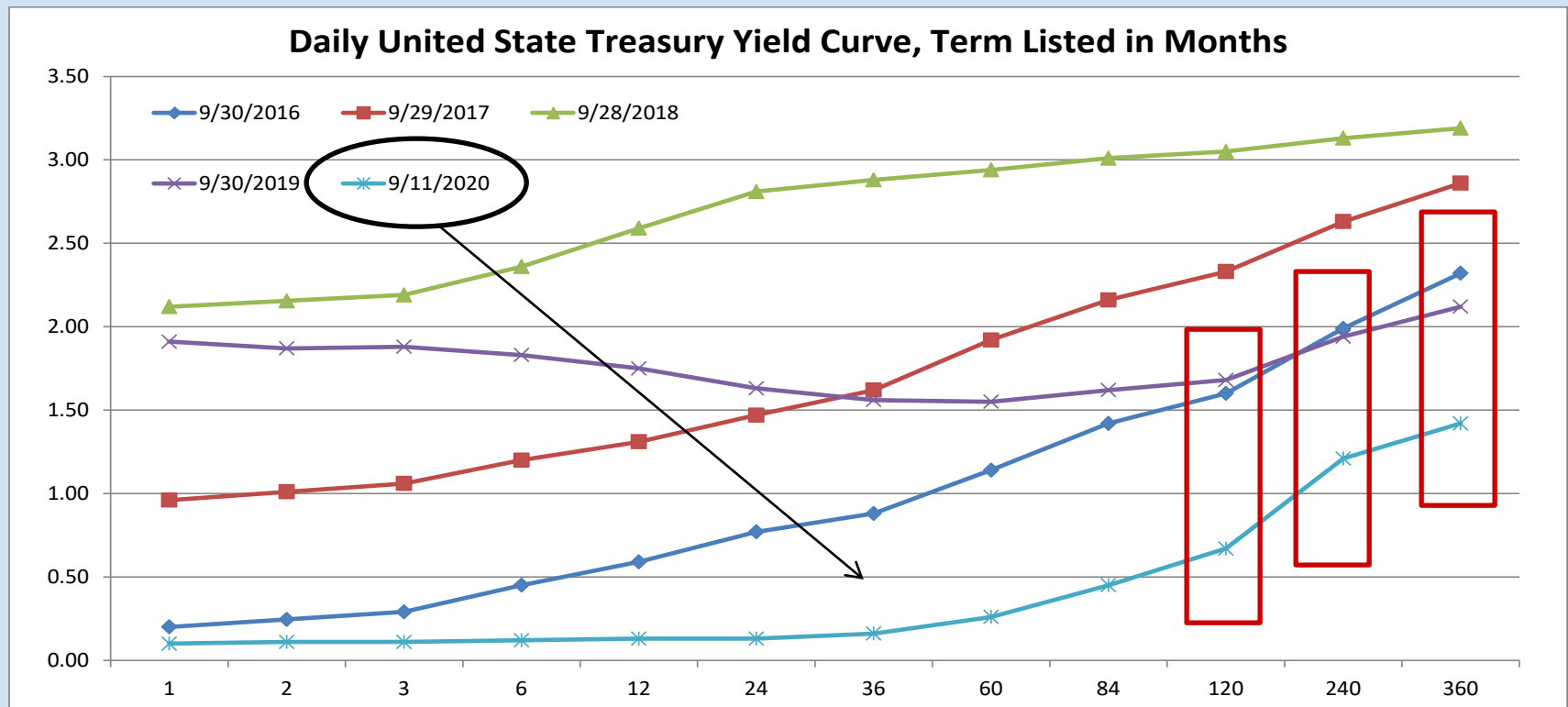
Note: downturn of interest rate environment will impact other areas—e.g., **cash flow/solvency testing**.

Annual **Asset Adequacy Analysis (AAA)** examines:

- expectations related to assets/investments and existing/written business
- with no inclusion of future-written business, current surplus
- over long horizon (30-50 years) economic scenarios... though all start with **current level of UST yield curve** (9/30 or 12/31)

Adverse results? May be required to hold additional reserves, above contract valuation obligation.

Level of the yield curve has **changed significantly** from where it has been in recent years:



- Yield curve is **70 to 180 basis points lower** than **Sept 2019**
- Long end (10-/20-/30-Yr) rates are **78-90 bp** lower than **Sept 2016**

Current level of UST rates could **significantly stress model results in 2020** for companies → additional reserves.

Sample year-on-year scenario comparison:

	2019			2020	
Position on UST Curve	Level 9/30/2019 (NY#1)	3% drop (also floored) (NY#7)	Historic Min pre-9/30/2019	Level (proxy) 9/11/2020 (NY#1)	Historic Min since-9/30/2019
3-year	1.56%	0.79%	0.28%	0.16%	0.10%
5-year	1.55%	0.78%	0.56%	0.26%	0.19%
7-year	1.62%	0.85%	0.91%	0.45%	0.36%
10-year	1.68%	0.91%	1.37%	0.67%	0.52%
20-year	1.94%	1.17%	1.69%	1.21%	0.87%
30-year	2.12%	1.35%	1.94%	1.42%	0.99%

- most years: “3%-drop” (NY#7) among least favorable
- 2020: expect “Level” (NY#1) results on par with 2019’s “3%-drop” results ... worsening from there.

Anticipate **major impact on AAA** for 2020:

- reinvestment rate
- policyholder behavior, future expense, expected claims?
(any items pandemic-related)

Results will vary by individual company—but plan for **YE 2020 reporting items** to be **materially worse versus previous years**'.

- Asset Adequacy Analysis (additional reserves?)
- NY Special Considerations, CA “Holiday Letter”
- Risk Based Capital (via C-3 Phase I)
 - scenario-based testing of **SPL and Annuity products**
 - same models/assumptions as AAA

Persistence of current environment?

1. Product re-pricing, new product design/development
2. Seek out investment/yield opportunities
→ fit business type, investment policy/risk appetite
3. **Game-plan for I.R.C. changes!** (not going away)
→ §7702: determines qualification as “life insurance” (via GPT or CVAT)
 - proposal: underlying rates “floating”: GSP (6%→ 4%?); GLP, CVAT (4%→ 2%?)
 - also §7702A: 7-Pay premium (4%→ 2%?) determines “MEC” status
 - design overhaul, higher cash values (i.e., discount rate no longer floored at 4%)
4. Potential for **removal of fraternal federal tax exemption**
(*“all bets are off” situation?*)

Several upcoming changes and future challenges facing the insurance industry.

Top-down awareness and preparedness

Board

Senior Management

Filing/Compliance

Investment

Operations

Actuarial

Producers, Marketing

Accounting

Systems, I.T.

Thank you for your time

Q & A

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Austin Swanson: aswanson@lifebase.com

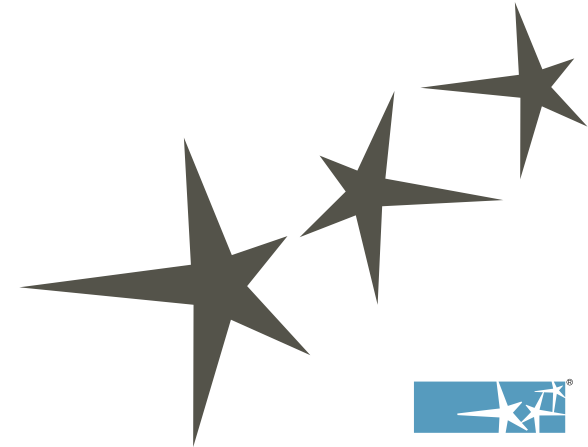
UPCOMING VIRTUAL EVENTS

September 29 | 11:15 A.M. CDT

Webinar – Monthly Compliance Update & Discussion

October 29 | 11:15 A.M. CDT

Webinar – Monthly Compliance Update & Discussion



ENCORE

EDUCATE + CELEBRATE

DECEMBER 15-16, 2020

VIRTUAL EVENT

12:00 pm – 2:00 pm Central

DAY 1 – December 15

Leadership Update, Fraternal Education Delegate Voting

Overture/Prelude



Alliance Board Chair

Timothy L. Kuzma



Alliance Chief Executive Officer

Allison Koppel



Mission & Vision Task Force Chair Presentation

Nicole Gourley, Chief Global Membership Officer,
Foresters Financial



Committee Updates

Drew Goesl, Capitol Counsel

Fraternal Education — Global Economic Update



Presented by:

Thomas Mucha,

Managing Director and Geopolitical Strategist,
Wellington Management

Fraternal Education — CEO Counterpoint – How to Make a Strategic Merger a Reality



Presented by:
Craig Van Dyke,
President & CEO,
Western Fraternal Life Association



Dan Shinnick,
President and CEO,
National Mutual Benefit

Adjournment of ENCORE Day 1

9:00 am – Noon Central

DAY 2 - December 16

Future Plans, Fraternal Education, and Virtual Roundtables

Virtual Gavel Presentation



Incoming Chair
Cynthia Maleski, National President & CEO,
First Catholic Slovak Ladies Association

Fraternal Education — Fraternal Jeopardy



Game Hosted by:
Barbara Cheaney,
Senior VP/Marketing Communications,
Catholic Life Insurance

Fraternal Contributions Finale

A celebration of the fraternal spirit in unprecedented times.

Adjourn to 90-Minute Roundtable Platform in the Virtual Ballroom

*Eligibility: Virtual Ballroom is open only to Fraternal Member Executives and Sponsors. All Alliance Members and approved non-member Industry Friends may attend ENCORE event through Fraternal Session #3.

10:30 am – Noon Central

Virtual Ballroom Fraternal Roundtables

Fraternal Executives* Will Connect “Zoom-Style” at Dozen of Hosted Tables for 90 Minutes via Amazing New Platform

Two Buildings/Four Floors

CEO/VIP Building (private; invite required)

- Leadership & strategy topics

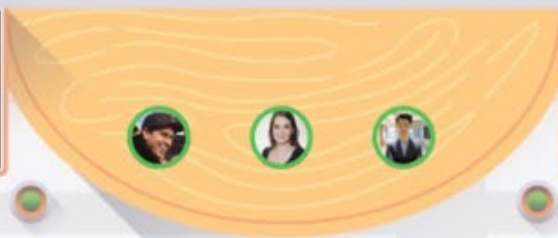
Main Ballroom Building

- Fraternal Floor offers chapter/community service/communications topics
- Operations & Governance Floor offers topics on tactical strategies and solutions
- Sponsor Floor offers business solutions and resource identification



Watch the speaker's full presentation

How to interview for a remote job that works...



Agenda (PST):

- 3:00 PM Networking
- 3:30 PM Q&A Live Video Streaming
- 4:00 PM Networking

ALLIANCE WEBINAR

***Thanks for joining us!
Please take the survey
when the session ends
and be sure to add
suggestions for future
topics.***

