FINAL EXPOSURE DRAFT
From PSRC & Pre-Need Committee
(Revised 28 October 2005)

STANDARDS OF ACTUARIAL PRACTICE IN PRE-NEED

~~I. DESCRIPTION OF PRE-NEED PLANS AND DEFINITION OF TERMS~~

~~1. Pre-Need plans fall under either of two general classifications: Contingent Benefit Plans or Scheduled Benefit Plans.~~

~~a. **Contingent Benefit Plans** refer to plans where the payment of benefits is dependent upon the occurrence of an unexpected event, like death of the planholder, or a decision of the planholder to utilize the benefits under the plan for another person of his choice upon occurrence of the contingent event of death to that person. Examples are funeral plans, memorial plans, mortuary plans, interment plans, cremation plans, etc.~~

~~b. **Scheduled Benefit Plans** refer to plans where the date of entitlement to the benefit is defined at inception. These include pension plans, education plans, travel plans and other similar plans.~~

~~2. Pre-need plans can either be Fixed Value Plans or Actual Cost Plans.~~

~~a. **Fixed Value or Fixed Benefit Plans** are plans wherein the amount of the benefit is fixed at the time the plan is purchased.~~

~~b. **Actual Cost or Traditional Plans** are plans wherein the amount of the benefit is the actual cost of such benefit or service at the time of payment of the benefit.~~

~~3. **Consideration** is the price paid for the purchase of a pre-need plan. Considerations under a plan are paid either in one lump sum or in installment payments.~~

~~a. **Net Consideration** is the portion of the Gross Consideration payable by the planholder for the principal benefits stipulated in the pre-need contract.~~

~~Net Consideration may sometimes be the Contribution to Reserve when determining Actuarial Reserves.~~

b. ~~**Gross Consideration** is the total of Net Consideration plus loadings for administrative and other expenses, as well as profit margins.~~

c. ~~**Expenses** include, but are not necessarily limited to, all expenses for plan acquisition, marketing, administration, and taxes.~~

4. ~~**In-force Plans** are plans for which the pre-need company has liabilities for promised or contracted benefits, or for the delivery of services. Included as in-force plans are:~~

   a. ~~Plans wherein considerations are still payable and which payments are either up-to-date or within the grace period provided for in the contract;~~
   b. ~~Plans wherein all considerations have been fully paid but benefits are not yet being paid or services are not yet being utilized;~~
   c. ~~Plans wherein considerations have been fully paid and benefits are already being paid or services are being utilized, but have not been completely paid or delivered.~~

5. ~~**Grace Period** is the period provided for in the pre-need contract within which consideration installments currently due may be paid without penalty and during which period the contract remains in force.~~

6. ~~**Lapsed Plans** are plans which are delinquent beyond the grace period in the payment of consideration installments due but within the period allowed for reinstatement to active payment status as defined in the contract.~~

7. ~~**Forfeited or Cancelled Plans** are plans which have remained delinquent in the payment of consideration installments due beyond the period allowed for reinstatement as defined in the contract.~~

8. ~~**Paid-up Plans** are plans wherein considerations have been fully paid.~~

9. ~~**Fully Availed Plans** are plans wherein the benefits or services stipulated in the contract have been fully paid or delivered.~~

10. ~~**Utilization Rate** is the ratio of the number or amount of plans that avail of the benefits or services within a given period, to the number or amount of plans in force at the beginning of the same period.~~

11. ~~**Lapsation Rate** is the ratio of the number or amount of plans that lapse within a period, to the number or amount of plans that are in force at the beginning of the same period.~~

12. ~~**Forfeiture or Cancellation Rate** is the ratio of the number or amount of plans that are cancelled at the expiration of the reinstatement period, to the number or amount of lapsed plans that have not expired at the beginning of the same period.~~

13. ~~**Reinstatement Rate** is the ratio of the number or amount of lapsed plans that are reinstated within a given period, to the number or amount of lapsed plans at the beginning of the same period.~~

14. ~~**Surrender** refers to the termination of the contract at the option of the planholder in exchange for its termination value at date of surrender.~~

15. ~~**Surrender Rate** is the ratio of the number or amount of plans that are surrendered within a period, to the number or amount of plans that are in force at the beginning of the same period.~~

16. ~~**Termination Value** is the amount that the planholder is entitled to be paid upon surrender of the plan prior to payment in full of the benefits under the contract.~~

17. ~~**Transferability** is a provision in the pre-need contract which allows the planholder to transfer his rights to the benefits and services defined in the contract to another person.~~

    ~~For Actual Cost Plans where the benefit is transferable or assignable, there is the risk of paying higher benefits than expected, unless the contract specifies the conditions otherwise for it to be transferable or assignable.~~

~~II. DETERMINATION OF GROSS CONSIDERATIONS OF PRE-NEED PLANS~~

1. ~~Gross considerations should be determined to include, but not necessarily limited to, all costs of all benefits stipulated in the contract, expenses, taxes, and profit and other margins.~~

2. ~~At inception, the present value of gross considerations should be equal to the present value of all benefits stipulated in the contract, expenses, taxes, and profit and other margins.~~

3. ~~Assumptions used for determining gross considerations should be based on the projected but prudently attainable company experience as justified by actual past company experience, if any, that may be adjusted for expected future trends which are realistic and applicable to the situation of the company.~~

III. DETERMINATION OF ACTUARIAL RESERVES

1. The Actuary must determine the actuarial reserves for all benefits stipulated in the contract. The benefits may be provided by the pre-need company directly, or

indirectly by transferring the responsibility for the delivery of such benefits to a third party.

2. The actuarial reserves for benefits shall be determined on a prospective basis.

   The actuarial reserves for benefits directly provided by the pre-need company must be equal to the present value of all future benefits directly provided by the company less the present value of the future contributions to reserves for such benefits.

   The actuarial reserves for benefits provided indirectly by the pre-need company should be equal to the present value of the cost of providing these benefits less the present value of the contributions to reserves to provide for these benefits.

   Actuarial reserves on pre-need contracts should never be less than the corresponding termination values.

3. The period within which contributions to reserves are assumed to be made should not exceed the period within which considerations are to be paid. For paid-up plans, future contributions to reserves are zero.

4. Contribution to Reserve for a particular period should not exceed the Gross Consideration for the same particular period.

5. Assumptions used in the valuation of actuarial reserves should reflect current experience of the company with respect to those assumptions, adjusted only for expected future trends, which are reasonable and realizable. Justification should be made for any assumptions used that do not reflect current experience.

   When updating assumptions, the changes in the assumptions and the effect of such changes on the actuarial reserves should be disclosed in the actuarial valuation report.

6. Expense reserves shall, whenever deemed appropriate, be set up for expenses to be incurred on the plan after the plan is fully paid.

IV. ASSUMPTIONS REGARDING INTEREST, INFLATION, EXPENSES, FORFEITURES, SURRENDERS AND OTHER CONTINGENT FACTORS

1. Assumptions and methods must be selected and applied with integrity, informed judgment and with perspective in relation to the purpose for which the results are intended. Actuarial assumptions should be appropriate to the specific circumstances of the company. They should be based on experience or anticipated experience, which is reasonably applicable to the specific business considering

the characteristics of that business and the trends which may reasonably be expected in the future.

2. The interest assumption shall be based on the yield rate or series of yield rates that are expected to be earned from investing the assets of the funds over the lifetime of the contracts involved.

   a. The yield rate includes dividends, interests and other investment income and is net of all investment taxes and expenses.

   b. Factors that may influence interest or yield rates include those that characterize the types of investments allowed, the company's current investment yields, cash flow patterns of the existing investments, and inflation rates. The interest assumption used for pricing should be that which at issue is sustainable over the entire term of the plan, while valuation interest assumption should be that which, at time of valuation, is justified as attainable over the remaining term of the plan.

   c. Forecast of investment yield rates should take into account the relationship of these rates to the contract durations and contract exposures to surrenders and payments of benefits on the contracts.

3. All expenses associated with acquiring and maintaining the business must be recognized in the determination of gross considerations, as well as in the annual valuation of actuarial reserves of the company.

   a. When testing adequacy of gross considerations, all expenses associated with acquiring and maintaining the business should be considered, including those expenses which are payable after all considerations have been paid. These should include acquisition costs such as commissions and overrides, issue costs and the like, licensing fees, registration fees, general administrative and other maintenance expenses, including expenses for cancellations and/or claims servicing, and taxes. If insurance cover is provided, the premiums payable during the entire period of cover must be included.

   b. As much as possible, when making assumptions on expenses, actual expense studies of the company should be used, modified only to reflect expected and highly probable future trends in the business; e.g. the effect on expenses of increasing volume of business and the effect of inflation on unit costs.

   c. Prudent judgment must be exercised as to the applicability of current expense rates to future years. Expense assumptions should reflect medium or long-term trends that match the expected duration of the contracts.

4. Inflation is the economic condition associated with rising price levels. It should be emphasized that inflation in benefit cost is specific for each product. It may be different, for example, for mortuary as compared to education plans.

   a. In pre-need contracts, inflation affects both the determination of gross considerations and the cost of benefits of actual cost plans.

   b. Inflation can affect significantly the following actuarial assumptions:

      i. Investment yield rates from various categories of investments

      ii. Cost of benefit of actual cost plans

      iii. Expenses for acquiring and maintaining and delivering the promised benefits

   c. Rates of surrenders, lapses and utilization for fixed value plans are likely to increase, while for actual cost plans, surrenders and lapses are likely to decrease with higher rates of inflation.

   d. The effects of inflation may be recognized in actuarial assumptions either implicitly or explicitly, except in actual cost plans where the effects of inflation must be considered explicitly.

5. Surrenders and lapses are occurrences that are entirely at the option of the planholder. Thus the effects of surrenders and lapses on all other factors must always be considered.

   a. The company's own experience should be used as a guide for making assumptions of expected rates in the future.

   b. Factors that affect these rates include type of plan, duration, amount of consideration, amount of benefit, inflation, selling practices, and economic outlook.

   c. Care should be taken when providing margins for deviations in these rates, and the effects of such deviations should be duly tested and provided for under different circumstances.

6. Utilization rate assumptions should consider the transferability provisions of the plan.

   a. As much as possible, the company's own experience should be used in the assumption of utilization rates.

b. Utilization rates for transferable benefits should include not only the contingent factors such as mortality for mortuary plans but also the option of the planholder to optimize utilization of the benefits especially under actual cost plans, such as to postpone the use of the benefits for a later time when costs are higher.

c. For memorial plans, the utilization rates to be used in pricing should not only be influenced by mortality rates applicable to the planholder but also by the possibility that the plan is assigned for use by another person.

V. DETERMINATION OF TERMINATION VALUES

1. In the design of plans, the actuary is expected to define the amounts of the termination values, and consider the same in determining the considerations for the pre-need plan. When asked to do so, the actuary should take into account the equities of all parties – viz. the planholder and the issuer of the plan. For example, equity of the planholder can be a measure of his reasonable expectation from the plan which he may opt to terminate, while equity of the issuer can be its right to collect the costs of a premature termination of the contract.

2. Termination values should represent the equitable share of both parties in the gross considerations minus the expenses of the issuer for the premature termination. However, the termination values should not be less than the minimum values set by the regulatory body.

VI. STATEMENT OF ACTUARIAL OPINION

1. The Statements of Actuarial Opinion should be based on sound actuarial principles adopting concepts in actuarial literature and utilizing accepted standards of actuarial practice and actuarial guidelines applicable to pre-need contracts. The Statements should clearly indicate the bases for such opinion. When making such opinion, the actuary must conduct sufficient tests and calculations on the data reflecting company experience for the specific contract types to satisfy himself of the appropriateness of his opinion.

2. A Statement of Opinion shall include:

   a. The actuary's name and his relationship with the company;
   b. The subject(s) on which the opinion is being made, describing the scope of the actuary's work;
   c. A statement expressing the actuary's opinion on the subject and the appropriateness of assumptions used; and,

d. A disclosure of any information which, if not disclosed, might reasonably be expected to lead to an incomplete understanding or misinterpretation of the opinion.

3. The Statement of Opinion on pricing shall include, in addition to Paragraph 2 above, an opinion on the adequacy of the considerations and benefit cash flows arising from the contracts. The actuary is expected to base his opinion on projections of considerations and benefit cash flows under various assumptions of future interest and inflation rates that could affect the contractual obligations under the plans, and to consider the characteristics of the contracts that are subject of the opinion.

4. In expressing an opinion as to the adequacy of the pricing of a pre-need product, the actuary must see to it that the assumptions used in such pricing have been adequately and effectively communicated to the company, including the possible effects of adverse deviations from these assumptions.

5. The Statement of Opinion on actuarial reserves shall include, in addition to Paragraph 2 above:

   a. A statement regarding the data or records which the actuary used in his valuation. If the actuary has relied on records supplied by an officer of the company or the independent auditor, he should make a statement to that effect, after having conducted a review and run the necessary tests;

   b. A statement of opinion on the assumptions used in calculating the actuarial reserves including, but not limited to, assumptions on interest or yield rates, rates of inflation, expenses, utilization rates and other rates of decrement. An actuary may use assumptions given by other experts only if he has tested such assumptions and is satisfied that the assumptions are appropriate.

   c. Actuarial formulations and methods used in calculating the actuarial reserves. If there are changes in actuarial formulations, methods and assumptions from those previously employed, the changes should be stated and the effect of such changes indicated in the Statement.

   d. A statement as to whether the actuarial reserves and other actuarial items:

      i. Are computed in accordance with commonly accepted actuarial principles, methods and standards, that are consistently applied;

      ii. Are based on actuarial assumptions which produce reserves at least as great as those called for in any contract provision as to reserve basis and method, and are in accordance with all other contract provisions;

      iii. Meet the requirements of the rules and regulations of the regulator as they pertain to actuarial matters;

iv. Include sufficient provisions for all actuarial reserves and related items which ought to be established, as well as all current and future obligations of the company guaranteed under the terms of its contracts, including items which are dependent upon the occurrence of events in the future, such as, for example, reserves for optional modes of settlement at maturity date of the plan;

v. Are computed on the basis of assumptions consistent with those used in computing the corresponding items in the preceding year-end, and if not, the change should be stated, and the reason for such change given, including the quantification of the effect of such changes in assumptions.

6. All pertinent and material information that will minimize the possibility of misinterpretation or misunderstanding by those relying on the actuary's work should be disclosed.

7. The assets of the Trust Fund and their yields are matters to consider in making assumptions for interest rates used in actuarial reserve valuation. The actuary shall make a statement about the effects of deviations of actual trust fund earnings from the assumptions that he used in the valuation of actuarial reserves. He should make a general comment on the quality and/or composition of the assets, particularly on how such assets can adequately or inadequately cover the benefits under the plans as they become due and payable.

8. An actuary must be prepared to justify the use of any procedures that depart materially from those set forth in these Standards and must include in any actuarial communication of the results, an appropriate statement with respect to the basis, rationale, and effect of such departures.

~~VII. STATEMENT OF ACTUARIAL OPINION ON COMPANY ASSETS INCLUDING TRUST FUNDS~~

~~1. Where there is a requirement to set up a separate Trust Fund for the liabilities of the pre-need company to its planholders, the Actuary shall compare the amount in the Trust Fund with the computed actuarial reserves. The actuary shall make a statement of comparison indicating the amount by which the Trust Fund is greater or less than the actuarial reserves computed.~~

~~2. The actuary shall make specific recommendations that the periodic deposits to the Trust Fund for each plan shall not be less than the contributions to reserves defined in Section III, par. 2.~~

~~3. With respect to financial statements, when the Trust Fund is included as asset in the Balance Sheet, the actuary should see to it that the actuarial reserve is also reflected~~

~~as a liability in the Balance Sheet. Otherwise, the actuary must make the necessary recommendation to have it included.~~

~~VIII. MINIMUM CONTENTS OF AN ACTUARIAL REPORT ON PRICING~~

1. ~~A Statement of Opinion on pricing.~~

2. ~~The description of the benefits under the plan, and the period for which considerations are payable.~~

3. ~~The actuarial assumptions used in the pricing, which shall include, but not necessarily be limited to, interest or yield rates, inflation rates, surrender rates, lapse rates, utilization rates, mortality or morbidity rates, expenses and profit margins. The bases for the actuarial reserves that affected the pricing shall also be indicated.~~

4. ~~Sample viability analysis showing results each year for all years from inception date to the end of the benefit payment period of the plan.~~

IX. MINIMUM CONTENTS OF A VALUATION REPORT

1. Statement of Opinion on the actuarial reserves.

2. A schedule showing the following information for the current year:

   a. Number and aggregate amount of obligation in the file of in-force plans;
   b. Actuarial reserves and aggregate amount of the paying plans, including those within the grace period;
   c. Actuarial reserves and aggregate amount of paid-up plans that are already utilizing the benefits and that are not yet utilizing the benefits;
   d. Actuarial reserves and aggregate amount of lapsed plans within the allowable period of reinstatement;
   e. Assets of the Trust Fund both at cost of acquisition and at market value as of valuation date as certified by the trustees.

3. A schedule showing the experience of the company for the last five years on the net investment rate of return on the Trust Fund assets.

~~X. RELATIONSHIP WITH AUDITOR~~

1. ~~When the actuary's work relates to financial statements subject to audit, the actuary should disclose to the auditor the actuarial assumptions and methods used.~~

2. ~~An actuary who is responsible for any part of the financial statements, which are subject to audit must fully disclose to the auditor his relationship with the company. Likewise, an actuarial opinion that is made part of the published financial statements should state clearly the relationship between the company and the actuary.~~

3. ~~Should the auditor be unable to form an opinion on the company financial statements on the basis of the information furnished by the company actuary, and the auditor consults with another actuary, the company actuary should make all related materials available for the other actuary's review, and be available for further explanation should this be required.~~

4. ~~The actuary should disclose his relationship with the auditor, if any~~.