PGN102: LIFE OFFICES - HIV/AIDS

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1. INTRODUCTION

    1. This professional guidance note is classified as **"best practice"** for valuators of South African life offices, and will come into immediate effect.

    2. The first duty of the valuator is to ensure the long term financial soundness of the office for which he/she is valuator. The AIDS epidemic is likely to impact on the profitability of all life offices, and may require them to restrict some of the business they might otherwise have sold.

       It is the professional duty of the valuator to bring these facts to the attention of the management of his or her office, and to ensure that appropriate action is taken.

       this professional guidance note has been drawn up to assist valuators in this process.

    3. The gravtiy of the unfolding epidemic is such that we appeal to members to cooperate with each other in finding solutions to this challenge.

2. VALUATORS RESPONSIBILITIESThis guidance note encompasses the following responsibilities:-

    1. Financial soundness and prescribed valuation

    2. Distribution of surplus recommendations

    3. Certification of premium rates

    4. Annual Actuary's Report

3. SPECIFIC REQUIREMENTSIn fulfilling his/her responsibilities listed in paragraph 2 above, the valuator is required to assess the following:-

    1. The expected financial impact of AIDS on the company in question.

    2. The possible methods for funding the financial cost of AIDS-related claims, including considerations of equity between different groups.

    3. The amount and timing of any additional reserves that need to be established.

    4. The financial soundness of all products being marketed.

4. ASSESSING THE IMPACT OF HIV/AIDSThe incomplete state of knowledge regarding AIDS and the vastly different experience which individual companies can expect, make it inappropriate for the Actuarial Society of South Africa (ASSA) to recommend specific techniques. The valuator must take into account all information particular to the company being valued in addition to generally applicable information.

This guidance note, therefore, emphasises processes that will necessarily be considered by a valuator in fulfilling his/her professional duties.

The different steps in evaluating the potential impact of HIV/AIDS on the life office are:-

1. **Considerations relating to sub-division of risk groups**
The valuator should analyse the office's experience and have regard to published information related to different groups at risk of HIV infection. The sub-division according to risk group should be such that the valuator can formulate a set of mortality/morbidity assumptions that realistically reflects the office's expected experience (including AIDS) and that enables him/her to test alternative scenarios.
In addition, the valuator should consider the potential impact of the following factors:-

    - AIDS underwriting classifications (pre-testing, tested/untested, AIDS exclusion clause)
    - Policy type (including options and adjustability of rates)
    - Anti-selection effect by year of entry
    - Anti-selection effect of future discontinuances
    - Geographic area

2. **Mortality/morbidity rates for future years**
The South African valuator has to address a more complex and more serious situation than that which is emerging in Western Europe or North American countries. Different companies can be expected to have very different claims experiences.

    The ASSA recommends that members use the latest information that has been supplied by the AIDS sub-committee as a starting point. Individual valuators will use adjusted values derived from these projections to reflect the expected experience of their office per risk group and the office's own expected proportions of business in each risk group as defined in the Doyle model. Alternative scenarios should be tested by individual valuators before finalising their mortality/morbidity rates.

3. **The effect of management action on future experience and on the allocation of the cost of AIDS related claims**

    It is acceptable for the valuator to take some account of the impact of likely actions by management, eg. premium rate increases, increased charges, reduced bonus rates etc, on the cost of AIDS claims, bearing in mind the reasonable expectations of policyholders.

    Consideration must however be given to the repercussions of such management action, e.g. selectively increased discontinuance rates, and to the scope that there is in practice to effect the proposed actions. Future changes in practice, bonus rates or charges should only be anticipated to the extent that the valuator is satisfied that they are likely to be applied in practice.

    In making his/her decision in this regard, he/she should take into account his/her knowledge of management actions taken in the past, and his/her view of the likelihood of appropriate tough decisions of this nature being taken in the future. If the company has not demonstrated in the recent past that it has taken action to increase charges or reduce benefits when experience warrants it, there must be strong grounds for believing that the company would act differently in the future under the experience projected, before the valuators can make appropriate allowance for any such action.

    Valuators are advised to document the agreed management strategy to deal with the effect of AIDS. This should encompass the underwriting policy; claims handling; exclusions; passing increased claims costs to defined groups of policyholders by way of reductions in bonuses, increases to mortality/morbidity charges, and if applicable, increases to premiums or other charges; policy regarding conversion and guaranteed insurability options; dividends and benefit illustrations.

5. VALUATION AND DISTRIBUTION OF SURPLUS

1. Amount and timing of additional AIDS reserves

The valuator must have a documented funding plan in respect of the additional reserves required. The board must approve this plan.

2. Valuation bases

The valuator must consider the method, context and use of different valuation bases.

3. Contingency reserves

The basic valuation liabilities should include reserves which are adequate to cover the additional mortality experience likely to be suffered by the life office, as outlined in this guidance note, after appropriate allowance, if any, for future management action, as indicated in Section 4.3 above.

In addition to these liabilities, the valuator should set up contingency reserves to allow for the risk of experiencing AIDS mortality higher than that assumed in the valuation. This is necessary because of the uncertainty relating to the future progression of the AIDS epidemic.

6. PREMIUM RATES AND THE ANNUAL ACTUARY'S REPORT

1. Approach

Allowance must be made for the impact of AIDS in new business premiums and the design of new products. The ASSA recommends the use of cash flow modelling techniques and a range of forecasts to assess new business profitability.

2. Profitable product range

In developing a profitable product range and strategy the valuator needs to consider specifically the target market selection; risk underwriting and HIV testing; product design and contract wording; premium rating; anti-selective persistency; contingency plans and policyholder's reasonable expectations.