

THE ACTUARY IN PRE-NEED PLANS

By
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A number of views and opinions expressed in this paper are personal thoughts and do not necessarily reflect those of the pre-need industry. These thoughts may be shared by some of you. Others may totally disagree.

I. Industry Background

The pre-need industry, as the name connotes, refers to contracts or plans that guarantee the payment or delivery as the needs arise in the future of some benefits in the form of cash or services. These contracts or plans are bought for some cash considerations payable for a specified period of time commonly one to ten years.

The most common pre-need plans in the Philippines today are:

1. Memorial life plans
2. Pension plans, and
3. Educational plans

Pre-need memorial life plans guarantee the mortuary services including the caskets in case of the death of the buyer. Usually, a memorial life plan paid on installment basis is considered fully-paid once the buyer dies because the buyer is usually covered by a credit life insurance.

Unlike memorial life plans which are concerned with deaths, pension plans, on the other hand, are concerned with the survival to old age of retirees, where they are provided pensions for life or for a limited period of time. Pensions are fixed at the time of purchase of the plan. They are usually in multiples of P100- or P500-monthly pension.

In addition to death and old age, pre-need plans through the pre-need education plans, serve a third purpose, namely: children's education. The buyers of pre-need educational plans are usually the parents or the children's relatives. These could also be purchased by foundations or corporations for their scholars. These plans answer for the tuition fees no matter how much it will be at the time the child enters high school or college. Pre-need educational plan companies usually offer three (3) types of plans according to the school category. Hence, the three types of plans correspond to the high-medium-and low-tuition fee schools.

Memorial parks may be excluded among the pre-need products since strictly speaking, it is but a real estate transaction where the buyer gets

the title to the property as soon as he has fully-paid the lot. Likewise, hospitalization plans or health maintenance plans were classified under pre-paid rather than pre-need plans because of their relatively short-term nature.

As of this writing, there are 39 pre-need plan companies registered with the Securities and Exchange Commission (SEC). As shown in Annex A, these are brokered down into 23 memorial life plan companies, 5 pension plan companies, and 11 educational plan companies.

Of these pre-need plan companies, the first to be established was the memorial life plan company in 1966, followed long after by the pension plan in 1977, then by the educational plan company in 1980.

Memorial parks, which most likely inspired the establishment of memorial life plan companies, were spearheaded by the Group Developers, Inc. (more popularly known to belong to the Loyola Group) while the Pacific Memorial Plan (Grealife-Yuchengco Group) introduced memorial life plans. Professional Pension Plan, Inc., on the other hand, was the one who started to mass market pension plans. Fourteen years after the establishment of the memorial life plan, the same person who introduced the memorial life plan introduced the pre-need educational plan concept and put up the College Assurance Plan (Phils.), Inc. or CAP.

II. The Market and Market Competition

By the very nature of each pre-need product line, we can somehow characterize the market to whom these products will cater to.

Memorial life plans being a direct preparation for death are mostly bought by old people. At old age or in a state of bad health, even scarce financial resources may not prevent one from purchasing a memorial life plan.

Pension plans, on the other hand, are purchased in preparation for old age or retirement. People with scarce resources will most likely not buy these. In fact, unless there is really an excess of funds, people will most likely shy away from these because they do not really give that much of an advantage over ordinary savings in a bank. Most likely to be purchased during their most productive years, pension plan buyers are likely to fall between ages 30 to 50.

While educational plans are really meant for children in anticipation of their secondary or tertiary schooling, the buyers of pre-need educational plans are the parents, and sometimes the relatives, of these children. At times, foundations or corporations may buy such for their scholarship grants. The children being young, i.e., below 11 years old, the parents ages are usually within the 25-to-40-year range.

The different pre-need plan companies, of course, compete with other pre-need companies in the same product line category. Apart from this, pre-need companies also compete with other pre-need companies in a different product line category and likewise compete with life insurance companies. Main reasons for these are:

1. All these products lines involve:
 - a. entrusting funds with the pre-need or insurance companies;
 - b. said funds are set aside for future, relatively unavoidable needs;
 - c. expenses or services attendant to these needs are paid off through the insurance proceeds or rendered by the pre-need companies at the time the needs arise such as at death or at a child's schooling.
2. It is not uncommon to find sales agents carrying these product lines. Likewise, sales agents selling one of the product lines are also quite aware of the other product lines. Hence, interaction as well as transfers of sales people happen quite often.
3. Due to the frequent interaction among these sales people, there is a comparison of product features, product prices, compensation structures, selling strategies, etc.

III. Product Pricing and Valuation

In product pricing as well as in actuarial valuations, the basic actuarial equation:

$$\text{Present Value (Benefit)} = \text{Present Value (Future Contributions)} + \text{Preset Value of the Fund, if any,}$$

is applied. Since not all of the premiums paid by a policyholder are put in to the trust fund, then the contributions referred to in the above equation pertain only to that portion of the premiums intended to be turned over to the trust fund.

In life insurance valuations, valuation premiums are lower in the first year than for the subsequent years to recognize the high first year expenses. In pre-need plans, the same premiums are used for valuation purposes but adjusted to the year-to-year trust fund contribution percentages.

Another way to price a product which may likewise be used in the subsequent actuarial valuations is by way of profitability studies employing the asset share method of valuation. Under this method, cashflow projections are made to see whether the premiums so exacted will produce comfortable margins for profits or contingency reserve.

Profits or provisions for contingency reserve may come from the following:

1. premiums received in excess of those earmarked for the trust fund and the expenses; and
2. profits from surrenders and lapsations.

In addition to the trust fund, the asset share may be considered as a buffer against unfavorable fluctuations.

A third method that may be used in valuing certain plans is applying the termination values of these plans. Termination values are the amounts to be paid to policyholders in case of surrenders.

IV. The Problems With Pre-Need Plans and The Problems Of The Actuary

As may be true in many companies, actuaries are often confronted with the difficult situation of explaining and convincing other people who do not have or have little appreciation of actuarial implications.

The situation even becomes more difficult when everything had been set up before the actuary comes and his job now is to set up remedies to cope up with the present state of affairs of the company.

Even the humblest actuary would perhaps say, things would have been better if he was there at the time the product was formulated.

One such area in which the actuary is readily to meet problems is in the area of pricing. In pricing, the actuary has to make certain assumptions. And as the old Chinese proverb goes "To prophesy is extremely difficult especially with respect to the future." Apart from being realistic, the assumptions together with the actuarial method should be such that:

1. it should be adequate.
2. it should be competitive, i.e. lower if not a par with those of competitors.
3. it should be reasonable to the policyholders.
4. it should produce handsome compensation package for the sales people, and
5. it should produce profits.

Due to the above requirements. I wish to point out certain items which to my perception are yet the problems of many pre-need-companies.

1. high compensation packages of the sales people.
2. high product prices, sometimes already unreasonably to the buyers.
3. tendency towards cut-throat competition.

Even the contract is something the actuary has to wrestle with. The contract is sometimes too open to selection by the policyholder against the pre-need company. As a consequence, some memorial life plan companies are undergoing very bad mortality experience, in the case of pre-need educational plan companies where there are only about three school categories, the children-beneficiaries would, of course, try all efforts to enter the very expensive schools in the category where they belong.

While the actuary may suggest certain provisions to safeguard the plan, these may be set aside in favor of saleability. In fact, even the very people who designed the plan sometimes virtually remove certain existing safeguards, again, in the name of saleability, or as concession to the buying public.

Hence, in considering the different parties with whom the actuary has to deal with namely, the Securities and Exchange Commission, the policyholders, the sales people, the management, the stockholders, the competitors, and even co-actuaries, to accede to some sectors may run contradictory to others.

V. Risk Management

What risks are the pre-need companies taking?

Foremost among the many functions of the actuary in a pre-need company is to inform the management and the stockholders of the risks and obligations they are entering into.

Since pre-need companies shall deliver the goods in the future, then necessarily, they have to absorb the increase in cost that have transpired from date of plan purchase to the date the benefits shall be availed of. These costs are the cost of burial in the case of memorial life plans and the cost of education in the case of pre-need educational plans. Since the amounts of benefits of pension plans are fixed at purchase, the risk of the increase in cost is practically nil in the case of pension plans.

Now, since pre-need companies, receive the money long before the clients' needs for the benefits arise, then they have some time to enjoy the investment yield of said funds.

Between the investment yields and the inflation runs, the pre-need companies stand to further gain or lose from some factors such as:

1. incidence of deaths.
2. incidence of enrolments (in the case of educational plans), and
3. rates of persistency or lapsations.

The primary concern therefore is to minimize the risks.

In pricing and actuarial valuations, this would mean computing under conservative assumptions.

Risks may also be minimized by certain provisions built-in the contracts especially those which will guard the company against selection by the policyholders. For example, in educational plans, the company should not make the mistake of answering for practically all of the school expenses but limit it to, say, just the tuition fees, in this way, there will be some form of actual cost sharing between the children's parents and the pre-need educational company. This will somehow put in the students in different schools rather than to just the very expensive ones in a particular category.

In anticipation of the high future costs of the services being offered, the pre-need companies may pre-arrange such. For example, in the case of memorial life plans, services may be pre-contracted with certain mortuaries. The contract may stipulate specific or no increases at all in the cost of the service over, say, 5 years. In the case of the educational plans, the pre-need company may buy scholarship chairs from certain schools. Of course, there should be some inducements for the concerned entities to accede to these arrangements. Loans may be one such inducement.

The pre-need company may even go on further to limiting its scope of coverage to certain mortuaries in case of memorial life plans or to certain schools in the case of educational plans.

The Securities and Exchange Commission (SEC), on the other hand, should set up controls to fulfill its regulatory and control functions, namely, to protect the public from irresponsible businessmen, to control the public from its own gullibility, and to prevent the business establishments from cut throat competition.

SEC should set up the minimum valuation standards for pre-need plans.

SEC may require for all pre-need companies, in addition to the trust fund, some contingency reserve equivalent to, say, 15% of the trust fund. This may be imputed in the price computations.

In addition or in lieu of the above, a capital build-up program proportionate to the risk may be required. For instance, the capitalization could be 10% of the trust fund but not less than, say, P3.0 million and not to exceed, say, P10.0 million.

Needless to say, SEC should look into the following:

- the provisions of the contract
- the adherence of the company to the scheduled trust fund depo-

sits and

- the quality and valuation of assets comprising the trust fund

VI. Should Pre-Need Companies Continue To Exist?

In any company, whether pre-need or not, if the company's leaders are not acting in good faith, then, by all means, that company should be closed.

Granted, therefore, that the proponents of pre-need plans or the leaders of pre-need companies, are acting in good faith, then to answer the above question "Should pre-need companies continue to exist?" then I suppose there are two things to consider, namely, the risk and the social good.

The three pre-need plans - is, memorial life plans, pension plans, and educational plans, as has been stated earlier deal with three eventualities - that of dying, getting old, and studying. The first two eventualities are unavoidable (and undesirable?) while the third one is desirable. If there is no chance involved in these eventualities, there are no risks to talk about. The chance then being addressed to by pre-need companies is the change in costs attendant to such eventualities.

Whether or not pre-need plans or pre-need companies exist, the risks of changing costs will always be there. While the time such costs will be incurred is highly predictable for old age and education, this is more uncertain in case of deaths.

What happens then is just a shift in the assumption of the risks of price changes. Before the existence of the pre-need companies, such risks are assumed by the would-be buyers or their families. When a pre-need plan is purchased, the risk was transferred to the pre-need company. The risks then would always be present. If the pre-need company will not assume them, certainly someone else would have to. Discounting fraud, therefore, no additional risk was injected in the economy or the society in the reaction of pre-need companies.

However, one may go on further to say that the risk now of the would-be buyers is the continued existence of the pre-need company.

Is there a particular social good accomplished by the pre-need company.

Everyone would want an honorable life as well as an honorable death. Maybe some would disagree but I suppose many would agree that to beg specially for oneself is not honorable. And one way of not begging is to save for old age which is the objective of pension plans. Coupled with honorable death, one would want an honorable burial and this is what memorial life plans hope to accomplish. I am not saying, though,

that if you have a memorial life plan, you are assured of an honorable death and an honorable burial. Honor may spell some things more.

Similarly, an educational plan does not assure one of high school or college education. But with an educational plan, someone can most likely dismiss one of the causes for not getting through high school or college, namely, financial reasons. As our president's message read for one of the pre-need educational plan companies in its anniversary:

"It is by learning that we become truly free: free from the poverty and oppression imposed by ignorance, and free to be all we can be as a gifted and daring people. Your participation in fulfilling the educational needs of our people makes your work important, foundational and therefore critical to the future of the Filipino people and that of our nation."

Should pre-need companies continue to exist? Are they the right parties to whom the risks should be shifted? If their existence contributes to the social good and they should be allowed to continue to exist, should they continue under the present form? If not, under what conditions should they operate?

DISCUSSION ON: THE ACTUARY IN PRE-NEED PLANS

Speaker : MS. AIDA C. JOSEF
Moderator : MR. REYNALDO C. CENTENO
Secretary : MS. PAULYN T. CASTRO

R. CENTENO:

In life insurance, we use mortality rates as the basis of premium computations, what do you use in pre-need companies?

A. JOSEF:

You can use in valuation and in pricing, factors such as interest rates and inflation rates. In addition to this, you can inject mortality rates, lapsation rates, surrender rates, and withdrawal rates. You can use the mortality rate if you want to consider the mortality rate of the children in case of educational plans. In case of memorial plans, you have to consider the mortality rates of the owner but since there are transferability provisions, this has very little effect in the cost.

L. TAN:

Lately, certain pre-need plans have become fixed amount benefit plans which no longer depend on the actual prices of the services they are supposed to provide. As fixed amount plans, they are more like endowments than anything else. Should not the life companies do something about this as they are impinging on the business of life insurance companies? In effect, fixed amount benefit plans are, for all practical purposes, endowment plans.

E. ROA:

Just a slight correction. The fixed value plans are really increasing sum assured whole life policies and the life insurance is carried purely by a life company. The pre-need plan takes care of the accumulation but whatever is the short fall between accumulation and the promised benefit is covered by the life insurance company.

L. TAN:

Yes, but still similar to increasing endowment.

E. ROA:

Not an endowment, Leo. But an increasing whole life.

L. TAN:

Whole Life for pre-need memorial plans but endowment for pre-need educational and retirement plans.

E. ROA:

Endowment at 100 if you want to be specific. What can the life companies do about it? It's up to each company's manager, I guess.

L. TAN:

With the pre-need plans impinging already on the business of life insurance companies, shouldn't the Insurance Commission step in?

E. ROA:

Just an observation. In your pricing on page 3, there is some indication that one of the accepted methods would be to consider as the future contributions the SEC required contribution to the trust fund. I dare say that in experience, the requirement of SEC as to what should go into the trust fund, the relation of that as to what should be set up would be purely coincidental. So, perhaps it should really be along the lines of what you have mentioned here where you actually go through an asset share calculation trying to forecast and the range of values of the trust fund which is required by SEC and of the additional accumulation which is generated by the contributions of the trust fund as required by SEC as the premiums or contributions for a plan.

A. JOSEF:

The trust fund contributions I'm referring to here is the trust fund contribution according to premium computations, not necessarily what the SEC requires. What the SEC requires is the minimum but you may put into the trust fund an amount more than that.

A. GARCIA, JR.:

Could you please give us an idea as to the degree of regulation, if any, being exercised right now by the SEC over pre-need plan companies? Is the present degree of supervision sufficient to assure the contract holders that there will be adequate reserves for the delivery of future services?

A. JOSEF:

The pre-need companies have been in existence for about 14 years. And I think the first regulations specifically intended for pre-need companies were formulated only in 1981. So with that, you can have an idea on the degree of the SEC control. For so long a time, the pre-need companies were let loose. At present, I think SEC is still groping on how to control the pre-need companies. That's my impression and I think they are crying out for help regarding this.

A. GARCIA, JR.:

This is an area where I think the actuarial profession could contribute significantly. Would you be able to say, from your familiarity with the pre-need industry, roughly how many companies or what portion of the industry is adequately reserved as of this time?

A. JOSEF:

I really don't have an idea but I can say that one of the problems of an actuary in a pre-need company is the absence of valuation standards from SEC. Without this authority, your management will not necessarily believe you. Worse, if you say something and a colleague of yours says another, then the problem is compounded.

E. ROA, JR.:

Consider first the pre-need memorial life plans. The face value of the plans in-force which are fully paid-up and the trust funds which are set-up are of public knowledge. So, just as a rough gauge of the adequacy or comparative adequacy of the funds, you could compare the unit trust fund. And if you have a situation where one company would have something like 6 as compared to one in the other, then the only conclusion is either one is inadequately funded or the other is overfunded. I think Mrs. Josef put her finger on the problem. I think this is a case where an Actuary is one who would rather be totally wrong than approximately right. Now, that could be interpreted in many ways. But that could be interpreted also in that the actuary has to take a position. In memorial life plans, one of the most conservative assumptions would be that the inflation rate equals the interest rate in which case the liability reserve would equal the current cost of all your paid-up services. That would be the most conservative. If there's a spread between the inflation rate and the interest rate, the reserve becomes less. I think that the situation is this. No matter how conservative the assumptions you make, I don't think you can come up with the statements that you would in life companies that you have made adequate provisions for all unmatured obligations of the company, because you don't have the same kind of reliability in your forecasts. But the best you can do would be to set-up a contingency margin which is fairly healthy and that also has been pointed out by Aida in her paper. But it's a slightly different ballgame from a life valuation. But there are certain rough gauges of just how adequate a trust fund is. And one of those gauges would be what is the reserve per thousand?

A. GARCIA, JR.:

Sometime ago, the Actuarial Society created a working committee to suggest standards of valuation that might be adopted by the SEC. Maybe this is an area that the incoming Board of Governors should follow up. As more and more pre-need companies come into the picture, there is a greater risk of misunderstanding that pre-need companies are no different from life insurance companies. If something wrong happens to the pre-need companies (such as a run or a default in their obligations), it could also affect the confidence of the public in insurance companies. We would be helping ourselves if we are able to somehow suggest steps that would significantly reduce the risk of failure of the pre-need industry.

E. ROA, JR.:

Chito, there was an exposure draft which was exposed but it was never reacted to. But I think that the new administration will probably find time to finalize the matter.

L. TAN:

In the meantime that there is nothing definite about valuation standard for pre-need plans, I think we actuaries, especially those involved in pre-need plans, should be extra careful in not being made used of by pre-need companies.

R. VIROLA:

You made a suggestion about one of the things that pre-need plans could do which is to pre-contract certain types of services like mortuary services. I wonder if this is something that should be allowed the pre-need companies because it will make supervision of pre-need companies more difficult in terms of providing protection to the buyers of pre-need plans. I think it is quite unfair because you are shifting responsibility from your company to another company where a different kind of supervisory authority will apply. And so I wonder whether this is something that should be allowed. You also posed the question: should pre-need companies continue to exist? I suppose that is not as relevant as the other question that you posed because I think, at this point, with people like Mr. Roa in the pre-need industry, I don't think that we have a choice. They will continue to exist. The relevant question is: What the Actuarial Society of the Philippines or the actuaries in general can do so that we will have a better supervision of and/or better operation of the pre-need companies. And in this light, Chito made the comment that sometime ago, there was a committee that was formed to help the SEC come up with valuation standards and I think that's one of the things that is lacking in the Actuarial Society of the Philippines. I remember that it was not even last year, I think it was even two years ago and up to now, nothing has happened. If we feel that it is an important issue, I think that the actuaries should do something about it. We are being overtaken by events. In the paper tomorrow, I think we are going to talk about non-actuarial matters that actuaries can go into. But this is something that we can very well help the SEC do its work as far as supervision is concerned. And yet, it's taking us a long time to help the SEC and the pre-need companies are here to stay and if they fail in their responsibilities to the public, the insurance industry can be affected and the actuaries will also be affected. And I feel that at the Actuarial Society of the Philippines should do something more drastic as far as this problem is concerned.

A. JOSEF:

With regard to your first question, should the memorial life plan company allow to pre-contract? And if so, should SEC recognize such

arrangements? SEC may or may not recognized such. But for the company itself, it might do them some good. That is hedging against price increases.

R. VIOLA:

I'm not worried about the company. I'm worried about the buying public-protection for the buying public. Because, now, instead of the buyer dealing with just one company, he is now dealing with two companies.

A. JOSEF:

The buyers may not necessarily deal with the mortuary itself but still with the pre-need memorial life plan company.

R. VIOLA:

Suppose the mortuary company dies?

A. JOSEF:

The liability is still with the memorial life plan company.

J. LIM:

I think it is high time now for the ASP, as a body, to issue numbered actuarial standards which members can refer to in case of any doubt. You will note that in the United States, whenever there is an issue like this, the Society of Actuaries normally issues valuation standards. Once, an actuary certifies something in accordance with the approved standards, then the member can count on the stand by him. But if the member deviated from the standards, then that is for the ASP Ethics Committee or any disciplinary body of the ASP to deal with. We should be independent of the SEC in that SEC regulates the legal requirements whereas the ASP regulates the technical requirements.

R. VIOLA:

At this point in time, the SEC is without human resources to come up with these valuation standards and by our training, we are probably in the best position to help the SEC. And I think the SEC is crying for help. So we cannot just say that we are independent of the SEC - you do it yourself.

J. LIM:

No, I'm not answering the question of Romy here. Because one way of helping SEC is once we come out with standards, automatically, we have helped SEC because SEC will just be concerned with legal requirements. They will not bother anymore with technical requirements or they will just do some auditing every five (5) years. What I'm saying is that I don't know of any ASP standards which has been mandated by ASP. I don't know if we have any insurance company valuation standards. I have not seen any since I became a member. And there

are also no pension standards. You know, we are always dealing with issues but we never come out with how our membership should behave in certain situations. My point is that it is now high time for us, as a body, since we are accrediting members, and the public perceives us the experts in this field, that instead of arguing in public, at least we come out as a body with certain standards.

D. GICARO:

This is not a question but just a comment. I recall that in 1984, when we had Commissioner Abello as our speaker in Baguio, he called upon the Actuarial Society of the Philippines to help the SEC in whatever decisions they might have in the regulation of the pre-need plans. This was in 1984, so the following year, we started the ball rolling with the exposure paper of Mr. Roa. After the paper by Chito Garcia, nothing was done afterwards. However, I recall that at the time the regulations were being put together, the SEC seems to have relied on heavily on the actuarial valuation that was required under the rules and regulations. Even at that time, when we commented on the lack of valuation standards in the regulation, for the lack of such standard was its requirement that there should be an actuary and an actuarial certification. So there was a lot of reliance on the actuarial certification. Even assuming that all actuarial certifications come up with standards, we are not sure at the moment that they are enforcing that requirement of an actuarial certification. We know for a fact that there are many pre-need companies presently that don't have actuaries or actuarial consultants.

A. BATARA:

I think even if SEC required the Actuarial Certification of an Actuary, that certification should follow the valuation standards as recommended by the ASP. As previously mentioned, there was already an exposure draft prepared by the committee in charge and headed by Mr. Roa way back in 1985 but nothing has happened perhaps and unfortunately because of the national events that took place in early 1986 and so it was just left at that stage. I think the best thing to do now is for the members of the future Board of the Society which will be elected today, to exert more effort in trying to have a full blown discussion of the particular Exposure draft with the general membership and if approved make a recommendation or endorsement to the SEC and/or the Insurance Commission for its implementation. It's up to this regulatory bodies to request for modifications of existing laws if it feels necessary to do so.