

Simplified & Guaranteed Issue Individual Life Products

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History & Current Product Structures

- This presentation is focused on individual products, comprising distribution channels: agent/broker, direct response, worksite, association/affinity groups, bank distribution and consumer-initiated such as via internet.
- Group products may entail quasi-individual simplified issue underwriting processes. Key factors are product types, group sizes and participation rates.
- Relatively new market – primary growth within the past 10 years or so. Originally intended to address needs of underserved middle market. Also used in the mortgage cancellation market.
- Targeted towards a broad demographic spectrum of insureds with issue ages generally ranging from 20 – 85. Average issue age in mid-40s. Female % generally about 2/3.
- Minimum/maximum issue amounts in the range of \$25 – 150K, although a number of exceptions on lower and higher side.

Product Structures (cont'd)

- Circumvents typical underwriting standards. Accelerates time to issue and may involve automated underwriting systems.
- Increased use of technology and alternate underwriting sources has streamlined the issue process and resulted in a gradual reduction in rates.
- Based on short form accept/reject application with generally 3-5 “knock-out” questions
- Some products may utilize a 3-tier product structure: a) true SIWL (SIWL), b) Graded death benefit (GDB) and/or c) Return of Premium (ROP)
- SIWL product usually level benefit Term, Trad WL or UL. Term & WL are most common.
- GDB and ROP versions provide graded benefits or return of premium over first 1 to 3 years. Note accidental deaths usually pay 100% of specified face amount.
- Common riders: ADB, child and waiver of premium.

Regulatory Issues

- Be aware of state-specific regulations which may impact product designs
- For example, Washington requires that death benefits exceed cumulative premiums. Premium rates can be as high as \$200/year.
- Unique regulatory requirements may necessitate design changes, such as lower compensation and/or lower maximum issue ages.
- Other states?

Federal Income Tax Issues

- Subject to standard 7702 & 7702A provisions
- Subject to normal deductibility rules in accordance with CRVM-based reserves
- Caveat: reserves based on 2001CSO mortality may not produce adequate reserves for this type of business. For instance, in practice we have seen mortality assumptions at 130% of valuation mortality.
- This creates potential tax issues with regard to tax reserves. Is this considered “reasonable” mortality under the safe harbor rule? Has there been a resolution?

Pricing Assumptions

➤ Mortality

- SIWL: Typical assumptions based on variation of 75-80 S&U M/F NS/SM table. Typical scalars applied to table may be 2.00 in first year for ages up to 45, grading to 1.20 for age 85. Additional durational factors grade to 100% in durations 20+.
- GI: Population based tables typical, sometimes 65-70 mortality table.
- A number of large carriers have also developed internal tables.
- In general, there may be significant variance between companies, particularly as application questions and underwriting processes differ.
- Some evidence of 3rd year mortality spike as contestable period expires, although does not seem as pronounced as originally expected.
- For smoker distinct products, consider effects of smoking antiselection where a % of smokers apply as nonsmokers
- Additional underwriting tools such as telephone interviews and prescription checks can significantly lower mortality, by 10%+
- Consideration should be given to potential lapse antiselection given the increased level of lapses for these types of products.
- Some modest level of mortality improvement may be factored in

Pricing Assumptions (cont'd)

- Lapse rates
 - Lapse rates significantly higher than underwritten business, possibly as much as two times higher during first few years. Eventually reverts to levels consistent with underwritten business.
 - The combination of lapse, mortality and high average issue ages may present problems with recovery of acquisition costs.

- Expenses
 - Should reflect marginal costs for a) telephone interview, b) MIB, c) percent of APS's anticipated and d) prescription database queries, as applicable for the company.
 - There are some standard industry prescription databases available – akin to MIBs.
 - Use of Rx queries and teleunderwriting can significantly reduce need for APSs, thereby lowering underwriting expenses.
 - Cost/benefit analyses have generally confirmed value of increased expenses associated with these underwriting tools.

- Investment rates
 - Investment rates should generally reflect assets with maturities of shorter durations than typical underwritten products

Pricing Assumptions (cont'd)

➤ Target surplus

- Use standard measures such as NAIC C-x factors, S&P, etc.
- 150-200% of company action level generally lowest. It is not uncommon to see levels well beyond this.
- Given the magnitude of premium rates, note that the C-4 factor (% of premium) will be more significant than usual

➤ Profit Objectives

- As expected considerable variance from company to company – e.g. Stat vs. GAAP, profit margins, ROIs, ROEs, breakeven, etc. Profit margins perhaps in the 8-10% pre-tax range. ROIs in the 12-18% range.

Underwriting

- Uses a short form application with 3-5 “knock-out” questions. Responses to these questions may determine offering of one of the 3 tier products, SIWL, GDB and ROP.
- Products almost always sex and smoker (nicotine) distinct. However, cannot accurately underwrite for smoking (nicotine use).
- Common application questions:
 - Hospitalization or nursing home confinement with the past 6 – 24 months – 12 is most common.
 - Physician consultation
 - Heart disease
 - Cancer
 - HIV
 - Stroke
 - Respiratory Conditions
 - Kidney disease
 - ADLs and/or cognitive impairment
- Application may be supplemented with other underwriting resources such as telephone interviews, generally to confirm application responses, MIBs, APS’s, prescription database queries and MVRs.

Underwriting (cont'd)

- Telephone interviews may be performed for each applicant initially, then transition towards every 5th applicant or so.
- MIBs are widely and frequently used
- APSs are ordered ad hoc, depending on the applicant.
- Since Rx queries are somewhat new, frequency is still a moving target and may vary from company to company.
- Automated underwriting systems may be used, with provision for manual intervention.
- Industry norm uses standard risk classification to table 4, although some carriers issue standard to table 6.
- Not takers may run into the 15 – 20% range.
- Overall, there can be considerable mortality savings relative to expenses incurred for these underwriting tools

Distribution and Compensation

- Over past several years there has been a trend towards higher compensation as companies compete for this market – as high as 130% of first year premium.
- Most common distribution channels: a) career & broker, b) banks, c) direct response and to a lesser extent d) worksite.
- At this point difficult to assess the extent of policy “re-writes”, although keep in mind the upward trends in compensation. Have we hit a ceiling?

Reinsurance Considerations

- Often not an issue because of policy sizes. However, as a new entrant to the market, a company may form a partnership with a reinsurer, perhaps reinsuring on a first dollar quota share basis to mitigate risk.

Anticipated Future Trends for SIWL/GI Market

- Increased migration towards technology-driven underwriting and issue.
- Wider dispersion of distribution channels and market penetration.
- However, possible market saturation.
- Development of more realistic production assumptions – these have been quite rosy in the past.
- Refinement of risk classes – preferreds?
Current point of controversy.
- PBR impact?