Actuaries' Club of the Southwest

RETURN OF PREMIUM TERM

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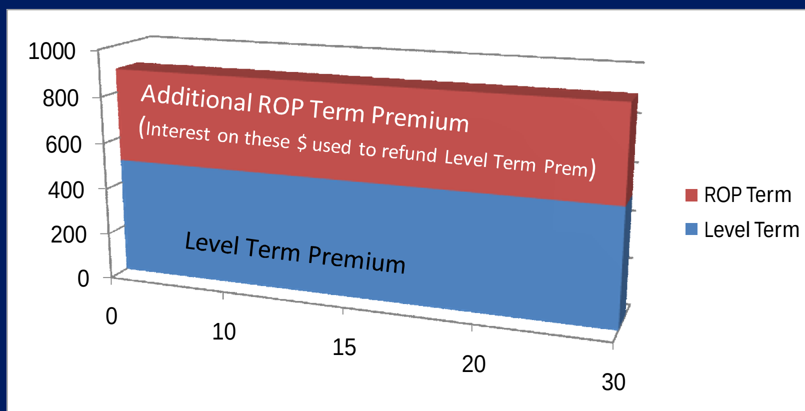
ROP TERM – Product Concept

- *Level Term Insurance but with refund of premiums paid at end of level premium term coverage period*
- *Bridge between Term and Universal Life as to cost*
- *Premiums refunded without interest*
- *"Buy Term & Invest the Difference" philosophy*
- *Compensation more attractive to Field Force as level term insurance premium/comp very low (and no comp on policy fee in general)*
- *Not Popular at Face Amounts > $1 Million*

ROP Term Premium



ROP Term - Premiums

- Unlike Level Term, ROP Premiums generally decrease as level term period increases due to impact of compound interest
- Not a hard & fast rule. Mortality costs may prevail
- Not generally feasible to offer 10 Year Product
- 15 Year still expensive (can be 4x level term prem)
- 30 Year Most Popular as cost is 25-50% higher than comparable level term (vs. 20 Year level term)
- ART Scale required if not exempt from SNFL – Guideline 22 Issue

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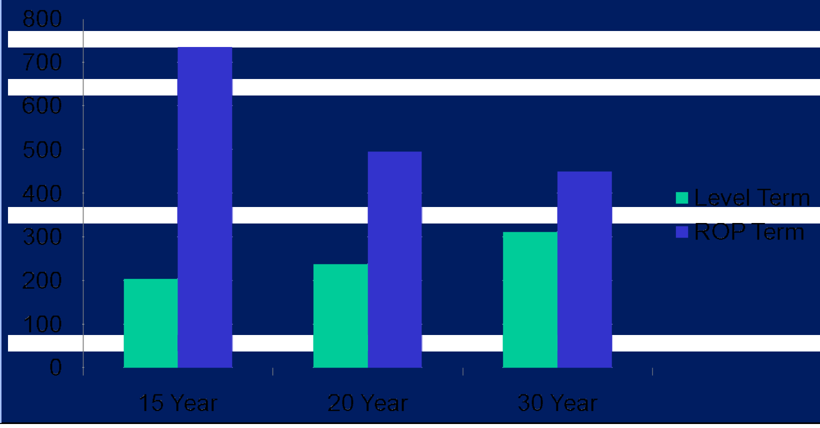
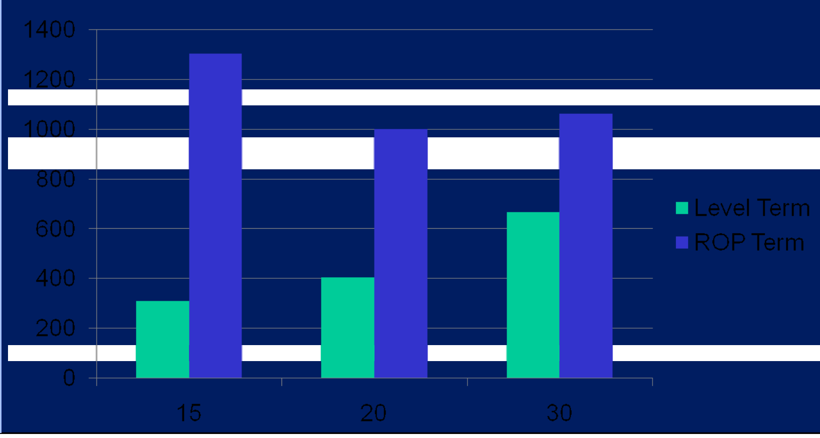
ROP vs. Level Term Prems (Age 35 - $250K)



ROP vs. Level Term Prems (Age 45 - $250K)



ROP Term Cash Values

- Product Concept is Return of Premium – focus is on providing this benefit at lowest cost.
- Thus, most designs provide minimal CV's.
- Most contentious issue for ROP Term is Minimum CV required by the SNFL
- Is the ROP Term benefit a Pure Endowment or Cash Value Life Insurance subject to the SNFL minimums? Chicken and Egg Problem.

Cash Value Levels – Industry Approaches

- Pure Endowment: Provide very low CV's (can be zero for 29 years on 30 year ROP).
- SNFL Minimums: Also, very low CV's using unitary approach. Often zero for 15 years or more on 30 year ROP.
- Percentage Approach: Attempt to offer low but "reasonable" cash values.
- Some companies offer an "Enhanced CV Rider"
- What premiums are refunded? Riders and substandard charges are refunded by some.

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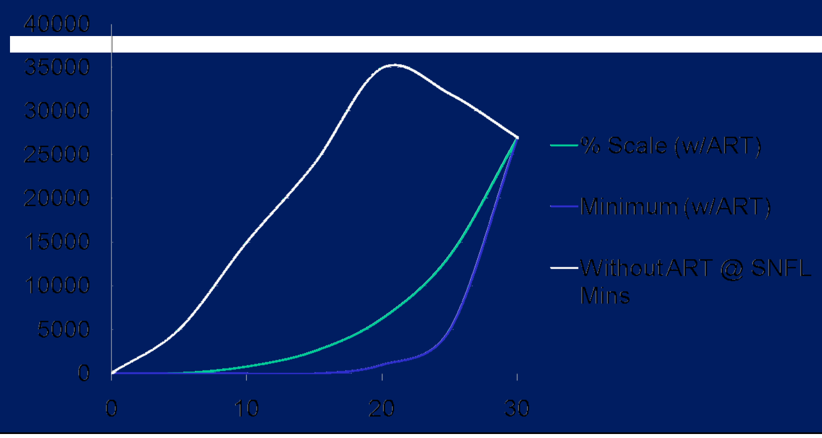
ROP Term – Cash Values & ART Rates



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ROP Term – Percentage Cash Value Scale

Duration	15 Year	20 Year	30 Year
0	0%	0%	0%
5	1%	1%	1%
10	30%	17%	9%
15	100%	50%	19%
20		100%	35%
25			60%
30			100%

Cash Values as a % of Premiums paid to duration shown

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ROP as CV Life Insurance – SNFL Issues

- ROP Term required to be treated as CV Life by many states & IIPRC/Guideline CCC
- RPU/ETI – ProRata Endowment? NY Requires.
- Must Include Endowment (if guaranteed) in PVFB
- Unitary Approach results in very low back-ended minimum cash values but Segmented approach not feasible
- Thus, many insurers provide > Min Rqd CV's using percentage method

SNFL – Smoothness Test & Percentage CV's

- Cash Value Insurance is subject to Section 8 of the SNFL (commonly referred to as the Smoothness Test).
- Convoluted Test applied in 5 year intervals. Essentially aims to ensure the slope of CV's remains within $2.00/Unit of the slope of the SNFL minimum CV's.
- Compliance is guaranteed if you provide the minimum SNFL CV's but Percentage CV method produces different pattern (as min required CV is low!)

SNFL – Smoothness Test & Percentage CV's

- Percentage Method does not follow the slope of the Minimum SNFL CV's in most cells. Thus, if percentage method is "marketed", CV's must be modified (upward only) at each cell/duration to comply. Complicated iterative process - computer intensive.
- Compliance with Smoothness Test is measured against SNFL Min Required CV's which do not incorporate policy fee.
- ROP Term CV's (on percentage method) by definition incorporate policy fee. Thus, even if CV scale tweaked to comply at one face amount, will usually fail at another if design has policy fee.

SNFL – Smoothness Test & Percentage CV's

- Many ROP Term benefits are provided as riders to base level term plans that feature a policy fee. Compliance with SNFL Smoothness Test utilizing percentage CV's seems impossible to guarantee.
- Same logic holds with modal premium factors. These serve to increase the premium and thus the cash value. Smoothness compliance unlikely unless company provides separate tweaked cash values for each premium mode.
- Compliance with Smoothness Test is also difficult to impossible if ROP benefit provides for refund of riders and/or substandard ratings.

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ROP Term – SNFL State Variations

- Many states do not enforce Smoothness (but it is still in the SNFL).
- **Maryland** has a DeMinimus Value of $15/$1000 vs. $25 in SNFL
- **Utah** does not permit Unitary approach. ROP Term not viable under this interpretation.
- **Minnesota** has argued prem. rates are too high (?)
- **NY** 149 prior to recent changes did not permit 30 year ROP (no Policy Test period exemption for level period – thus Utah). 15 & 20 difficult/expensive. Circular.

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ROP Term – SNFL State Variations

- **New York** still enforces Smoothness Test. Requires ROP RPU/ETI. Requires $2.00/Unit cash value in first 5 year period.
- **Florida** attempts to enforce Smoothness Test
- **California** (until recently) was similar to Florida
- **Pennsylvania**: Eyeball approach to Smoothness Test. Stopped approving new ROP Term policy forms in August 2007. Has new requirement for Minimum CV's. Min CV calc'd using the Endowment benefit only over level term period wth full EA (Endowment and life benefits). More liberal than CCC. Prefers no UCV XXX Reserves. Appears possible to obtain PA approval at present.

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IIPRC & Actuarial Guideline CCC

- The Interstate Compact drafted preliminary standards for ROP Term filings in early 2008. Committee included regulators from Utah, Florida, PA. Focus on CV levels & Smoothness.
- Original Proposal would have precluded ROP for plans of more than 30 years or which endowed at age 81+. Subsequently removed this provision.
- The Industry (via the ACLI) argued against the IIPRC instituting new requirements. There is a current lack of uniformity in interpreting the SNFL for ROP Term by the states now and IIPRC standards would have compounded the situation.

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IIPRC & Actuarial Guideline CCC

- IIPRC considered approaching the NAIC to modify the SNFL but felt that approach would be too slow. Thus, the decision was made to draft an Actuarial Guideline to address the uniformity issue.
- The ACLI also attempted to modify various other aspects of the IIPRC proposal …most notably the new minimum CV requirements but w/o success.
- Actuarial Guideline CCC is essentially the IIPRC proposal without the age/duration limits.

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Actuarial Guideline CCC

- ROP as a rider is to be considered integral part of policy (eliminates Pure Endowment exemption)
- Clarifies AG22. CV's are greater of those produced using current or guaranteed premiums
- Minimum CV's increased to greater of:
  - the Unitary Method
  - CV's calculated over the level premium period for the Endowment and 7702 Corridor death benefits using the EA for the level period only (and calc'd w/o regard to base death bens)

Actuarial Guideline CCC

- Requires compliance with the Smoothness Test (specifically refers to Section 8 of the SNFL)
- Tentatively effective 1/1/09 and required for all policies issued on or after 1/1/2012 (as exposed)
- Expected to be adopted by the NAIC at the Fall meeting (possibly not until December but still on a rapid pace).

Impact of Guideline CCC

- ROP will be available in Utah and PA
- CV requirements are sometimes higher and sometimes lower than current percentage scales in use. Overall, somewhat higher. Premiums should increase somewhat (2-5%).
- Smoothness Test requirement may drive carriers to set cash values at legal minimum. However, not as simple as it sounds as the minimum will vary as premiums change. Thus, may eliminate modal loads, policy fees, rider and substandard refunds unless CV's calculated by formula. Most admin systems for term do not handle formula CV's.

Impact of Guideline CCC

- Riders to Currently sold level term plans will probably disappear in favor of stand-alone designs.
- AG22 wording will probably drive fully guaranteed CV and premium designs.
- Efforts will be made to ensure no 7702 Corridors are violated in the product designs due to complications that will raise in CV calculations.

ROP Term – Pricing Issues

- Level Term Insurance pricing is most sensitive to mortality fluctuations.
- ROP Term is very sensitive to the lapse rate and assumed earned rate on the assets.
- General consensus is that lapse rates on ROP Term will be very low but no real data beyond 5 years.
- Experience in very early durations (1-3) is similar to level term but shows signs of rapidly declining in durations 4-5. Ultimate lapse rate of 1% may be appropriate.

ROP Term – Pricing Issues

- Mortality: Probably better in early durations than level term insurance as less anti-selection…but much of the level term anti-selection occurs on the short period products (i.e. 10 Year Term). ROP 30 may be similar to level term insurance of 30 years.
- ROP Term may develop XXX Unusual CV Reserves (particularly at the later durations as the CV ramps up).
- Less distribution at high face amounts.

ROP Term – Section 7702

- As ROP Term does not feature a true "account value", the use of the CVA Test seems most appropriate.
- Care should be taken with respect to the interest rates assumed in the Net Single Premiums. "interest at the greater of 4% or the rates guaranteed on the issuance of the contract"
- Blue Book states rates guaranteed on issuance (if not explicit) may be implicitly stated by a guarantee of particular cash values.

ROP Term – Section 7702

- Study Note 441-87-88 "Definition of Life Insurance" (Pg 10) indicates that an implicit interest rate can be derived as a balancing item in a year by year comparison of the CV's using a Fackler accumulation formula.
- Interest rates derived in this fashion can be greater than 20% in later policy durations!

Thank You

Questions?