SOA Product Development Section Webcast
"The Impact AG CCC will have on ROP Term"
Followup Q&A

On March 11 the SOA Product Development Section sponsored a webcast to educate actuaries on Actuarial Guideline CCC (or the Guideline, or AG CCC)[*]. Due to the large attendance (a record 149 locations signed up), there were many more questions than could be addressed in the time allotted. Given that this is such a new and important topic, the faculty decided to prepare answers for all questions submitted and email them to the participants.

Due to the nature of the webcast medium, all of the questions were submitted in hastily-composed written form, requiring most of them to be rewritten and were, in many cases, subject to interpretation. Many of the questions also addressed the same issue, so they were combined as part of this process. Some questions were split into two parts and some questions were dropped because they were not directly related to the topics presented.
It is also important to keep in mind that the faculty was chosen based on their knowledge of Actuarial Guideline CCC, the Compact [**] standards and/or some of the general pricing considerations for ROP Term products. None of the faculty members are in a position to make definitive statements about the intention of the drafters of Actuarial Guideline CCC or the Compact standards, how the states or the Compact staff will interpret the Guideline or the Compact standard, or the specific effect the new guideline will have on pricing or sales of this product. Nothing conveyed in this document should be relied upon for legal purposes.

Questions and answers are loosely organized by type of question.

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[*] This Guideline has now been officially named Actuarial Guideline XLV, but to be consistent with terminology used in the slides, we will continue to call it AG CCC throughout this Q&A.
[**] The Compact is officially called the Interstate Insurance Product Regulations Commission or the IIPRC, but to be consistent with terminology used in the slides, we will continue to call it the Compact throughout this Q&A.

Applicability

Q1: Does AG CCC apply to a Pure Endowment feature providing an intermediate ROP or near-ROP at the end of a set term but having no prior cash values?

A1: *The scope of the guideline states that it applies to any individual insurance policy (except for adjustable life) that includes an intermediate endowment. The guideline further states in A.2 that for minimum cash value purposes the policy and any ROP rider shall be treated as integrated.*

Q2: Does AG CCC apply to Pure Endowment riders that offer ROP at the expiry date of the base policy, but have no intermediate cash values?

A2: *No, but the combined product could be viewed to be endowment insurance required to have cash values under the Standard Nonforfeiture Law for Life Insurance (SNFL).*

Q3: Does the AG CCC apply to ROP benefits provided in connection with the Long Term Care Insurance?

A3: *No. The Guideline only applies to individual life insurance.*

Q4: Are indeterminate premium ROP policies exempt from AG CCC?

A4. *No. The indeterminate premium policies that offer endowment benefits prior to the expiry date of the life insurance coverage are within the scope of the Guideline. For such policies, minimum values have to be the greater of those produced using the current and guaranteed premium rates. However, indeterminate premium ROP products are outside of the scope of the Compact standards, so they could not be filed with the Compact unless additional standards were created.*

Q5: Would a true endowment at 95 for the face amount that has a premium structure with premiums level and guaranteed for 30 years and annually increasing thereafter (whether guaranteed or indeterminate) structured with cash values (only available by surrendering the policy) pegged so that at end of level premium period the CV amount is approximately equal to premiums paid to that point fall under the scope of the Guideline? If so, does it apply with an endowment at 95, or is it calculated as if the endowment were at 30 years?

A5: *No, if the cash values were set equal to the minimums required by the SNFL for an endowment at 95. Yes, if the 30 year cash value were much higher than that minimum, and equal to or nearly equal to the ROP. In this case, the policy should be treated as a 30 year intermediate period endowment, consistent with the section of the Guideline which reads, "However, other products within the scope designed to provide similar benefits, and having similar premium structures (for example products having a cash value at the end of an initial level premium period equal to the total premiums paid) would be expected to provide minimum cash values that are determined in a manner consistent with this Guideline."*

Q6: Does the AG CCC apply if the endowment occurs at the time of policy expiry?

A6: *No, if the cash values are set equal to the minimums required by the SNFL for an endowment policy. Yes, if some intermediate cash values are much higher than that minimum, and equal to the ROP, consistent with the response to Q5.*

Q7: For riders attached to a ROP product that provides separate cash values not related to the base policy, are the riders subject to AG CCC?

A7: *The rider would not be subject to the Guideline unless it was a policy that also had some sort of endowment benefit similar to the ROP structure. Otherwise, AG CCC applies if the premiums associated with the rider are returned in the ROP benefit.*

Treatment of Reduced Paid-Up Nonforfeiture Values

Q8: Does the Guideline require that reduced paid-up (RPU) option be offered as a nonforfeiture benefit? If yes, what should be the term of the RPU: to the endowment date or to the expiry date of the policy?

A8: *The Guideline is silent on the form of the nonforfeiture benefit. It only addresses the minimum cash value amount. The Compact standard requires that at least RPU be offered as a nonforfeiture option; additional options may be provided. The RPU option is meant to provide for the reduced amount of life insurance to the expiry date of the policy, consistent with the nonforfeiture requirements of other Compact standards (Individual Term Life and Whole Life Insurance Policy Standards).*

Smoothness Test

Q9: It is very difficult to get these products to comply with the smoothness test for every cell (every issue age, underwriting class, etc.) if the cash values, as a percentage of premiums paid, are the same for all cells. Do you expect that the smoothness test needs to pass every cell? If so, it would appear that many different sets of cash values will be necessary.

A9: *The smoothness test needs to be passed for every cell, according to section C of the Guideline. To comply, actual cash values, as a percentage of premiums paid, will likely have to vary with age, gender, underwriting class, etc. The Compact standards require the actuary to certify that an adequate numbers of scenarios have been tested "to ensure compliance for any given endowment period, at all ages, genders, underwriting classes, face amount bands and rider/policy combinations."*

Materiality Test

Q10: CVAT Compliance often requires an insurer to use "implied interest rates" that are higher than the 4% minimum due to the cash value slope. Are the regulators aware of this,

given that CVAT is now part of the Compact Tests and that it is a tax issue not normally of concern to regulators?

A10: *We cannot answer as to the individual states response with regard to the guideline or Compact standard established. It should be noted that this calculation is only meant to be a safe harbor, chosen since it is a calculation that companies are already doing. The Compact does not look at it as a tax issue.*

Q11: What would be an example of a benefit that exceeds the NSP-based safe harbor under the Compact standards but still complies with 7702?

A11: *The Compact standard for calculation of the NSP safe harbor is based on a level face amount. The endowment benefit could exceed the NSP for a level face amount, but the company can change the future face amounts to comply with 7702if using CVAT testing.*

Administrative Questions

Q12: Is the draft of the ROP Compact standards available on the Compact's website?

A12: *Yes. It can be found on the Interstate Insurance Compact website at www.insurancecompact.org. As of the Webcast date, it was under the "Docket" tab. Once adopted, it will be under the "Record" tab.*

Q13: Where can one get a copy of AG CCC? Is the spreadsheet used to demonstrate compliance included?

A13: *The official name of the Guideline is AG XLV. It will be published in the March 2009 edition of the NAIC AP&P Manual. Those that have preordered the Manual, can access the Guideline online, at http://www.naic.org/committees_e_app_manual_updates.htm. The Guideline is also available for purchase from the NAIC Research Library. There is no compliance spreadsheet included in the Guideline. The Compact has a compliance spreadsheet (i.e. a required compliance format) that can be found in the appendix to the ROP Compact standards. Individual states may have preferred/required formats for compliance demonstrations.*

Calculation Details

Q14: What is the impact on accelerated death benefits of the requirement that the endowment benefit cannot be reduced by claim payments?

A14: *The Guideline does not address the impact of accelerated death benefits or any type of claim payments on cash values. The term "claim payments" in the Compact standard was not intended to apply to accelerated death benefits. The Compact standards specifically allow for a reduction of endowment benefit and cash values following acceleration of death benefit. The Compact standard says, "If an accelerated death benefit is attached or built into the policy, the endowment benefit form shall state that the endowment benefit amount, cash values and* *premiums will be reduced if an accelerated death benefit is paid, and the reduction will be consistent with the terms of the accelerated death benefit form. If the accelerated death benefit form does not address endowments, then the reduction in the endowment benefit amount shall be consistent with the requirement for the reduction in policy cash values. Such reduction in benefit amount is not to exceed the endowment benefit amount."*

Q15: What are the mortality and interest assumptions for the minimum nonforfeiture calculation?

A15: *Mortality and interest should be those applicable under the SNFL to the entire policy, taking into account the entire period for which the death benefits are guaranteed subject only to the payment of required premiums.*

Q16: What nonforfeiture values are required in the case where the ROP benefit is provided through a rider, and the rider is terminated by the policyholder prior to the maturity date of the ROP benefit?

A16: *The Guideline does not address this issue. Under the Compact standards, the Company would have the option not to allow for the termination of the rider only. However, if it is allowed, the payment of the cash value is required, and the amount to be paid needs to be at least equal to the excess of the total cash value for the policy and the rider over the remaining cash value of the policy after termination of the rider.*

Q17: If the endowment period is less than 10 years how do you determine the average amount of insurance (AAI)?

A17: *If the amount of insurance is level throughout the lifetime of the policy, any reasonable interpretation should yield AAI equal to the death benefit. If the amount of insurance significantly increases after the endowment period, it may be more appropriate to either calculate the AAI over the endowment period, or ignoring death benefit increases after the endowment period.*

Q18: For indeterminate premium products, which adjusted premium should be used when performing the smoothness test?

A18: *This should not be treated any differently than compliance demonstrations for any other indeterminate premium product.*

Q19: When there are multiple endowments, is each minimum to be determined from issue?

A19: *The Guideline does not provide a specific guidance with respect to multiple endowments. Whether a particular approach is appropriate may depend on the specifics of the design, the rationale for multiple endowments, the premium scale, etc. Under the general principles of the SNFL, additional endowment benefit should not cause a decrease in otherwise required cash values.*

Q20: Is there any guidance regarding interim (off anniversary) CSV's for ROP Term?

A20: *The Guideline does not address this issue. Off anniversary cash values would be expected to comply with Section 7 of the SNFL and any additional state specific requirements.*

Q21: In the absence of the incremental death benefits, is expense allowance (EA) equal to zero for Endowment NF value calculation?

A21: *No. The expense allowance is calculated using Average Amount of Insurance in the first ten years. The amount of insurance for a given year is the amount of death benefit, not just the incremental death benefit.*

Q22: When you refer to non-guaranteed premiums, do you mean on the term life policy or the ROP rider?

A22: *"Non-guaranteed premium" refers to any gross premium for the policy or the rider(s) that is required to be included when calculating adjusted premiums under either the Guideline or SNFL.*

Q23: When you refer to a maximum age of 80, do you mean issue age or attained age?

A23: *The Guideline does not place any limitations on the timing of the endowment benefit. The proposed Compact standards require that the endowment period does not exceed 30 years and that the insured's attained age at the time the endowment matures does not exceed 80.*

Filing Questions

Q24: When filing an ROP product directly with a state that is a member of the Compact, but not intending to file through the Compact, does the Compact standard apply?

A24: *No, not directly at least. But it is possible that the state in its review will use the Compact standard as guidance.*

Q25: For companies that have already filed ROP products with the individual states, does the Guideline impose any new/additional filing requirement?

A25: *No. The Guideline does not impose any filing requirements. However, it requires that any policy issued on or after January 1, 2010 provide values compliant with the Guideline, which might necessitate a new filing.*

Q26: Regarding Guideline's effective date, does issue date of the policy refer to the actual issue date or the date the policy was applied for?

A26: *Issue date refers to the issue date of the policy as shown on the policy's specification page.*

Q27: Would states expect the NF spreadsheet demonstration if not filing with a Compact?

A27: *Not necessarily. State filing requirements vary. Contact individual states regarding state specific filing requirements.*

Compact Requirements

Q28: Do the Compact standards allow companies to prohibit individuals from signing over their ownership rights to ROP policies?

A28: *The Compact standards do not allow companies to restrict ownership rights of an ROP policy except to the extent permitted by state law.*

Q29: To what extent will Compact requirements be applicable in all states?

A29: *The Compact requirements will be applicable to products filed with the Compact. It is difficult to predict to what extent the same or similar requirements will be adopted by individual states. It is possible that a non Compact state may use Compact requirements as guidance in its review process.*

Pricing and Product Design Questions

Q30: Min CV is larger of that resulting from current and guaranteed premiums. What is the expected impact on profitability of a min CV scale based on guaranteed premiums while a policyholder is paying a current premium scale?

A30: *This is not likely to happen. The guideline contemplates an endowment benefit that is fixed and known at issue (for indeterminate premium policy, it could be a multiple of first year premium). In that case, minimum cash values would be based on current premiums because they exhibit a less steep pattern. The intent of the guideline was to disallow the use of guaranteed premiums during the endowment period to lower the minimum cash values.*

Q31: What are advantages and disadvantages of having non-guaranteed premiums (having both current and guaranteed premiums) during the endowment period? Why is this design losing popularity?

A31: *Generally, non-guaranteed products have a shorter level guarantee period with a longer projected level premium period (e.g. 10-year guarantee level and 30-year projected level). This shorter guarantee period could allow for a lower reserve due to the XXX reserve being based on a 10-year guarantee rather than a 30-year guarantee (similar to non-ROP term products). The design was likely losing popularity because of the market wanting guaranteed premiums rather than non-guaranteed premiums (similar to non-ROP term products). Also, if the plan was illustrated at all, illustration testing would be required and passing the lapse support test may have been problematic.*

Q32: In the presence of multiple riders, returning all actual premiums paid produces an enormous number of possible endowment and cash values, making compliance with smoothness test very difficult. Do you think that AG CCC will eliminate products where ROP benefit includes premiums paid on all riders attached to the policy?

A32: *Not necessarily, but it may limit the ages at which this type of benefit may be feasible or profitable.*

Q33: How can you have a design with current & guaranteed premiums if you must show the dollar amount of the endowment in the policy?

A33: *The Guideline does not address how the endowment is to be shown in the policy. The Compact standards only allow guaranteed premium rates in the endowment period. A policy with a ROP benefit and a current and guaranteed premium scales during the endowment period could not be filed with the Compact, but, if filed with the individual states, would be required to comply with the Guideline.*

Q34: What are companies assuming for interest and mortality for 7702 compliance testing?

A34: *The panel does not profess to be experts in tax or legal issues. Any tax or legal issues should be addressed to your tax or legal advisor. The interest rate used must be the greater of 4% or the rate guaranteed within the contract. Various interest rates have been used for the rate guaranteed in the contract – 4%, whatever the NF interest rate is if higher than 4%, or the rate implied in the contract based on the guaranteed cash value at each duration.*

Q35: What impact do you think the higher cash values associated with AG CCC will have on overall ROP Term Sales?

A35: *Any increase in premium could potentially affect sales for a company. It is difficult to say how much sales could be impacted due to any premium increase versus other factors, like the economy and sales levels in general.*

Q36: What is the meaning of "possible" when comparing current and possible cash value scales on slides 46 through 48?

A36: *Possible means that one could possibly generate cash values through the smoothness test pre-AG CCC that meet minimum cash value requirements (due to large ART premiums driving down cash values to the point of non-existence) and have a pattern as illustrated.*

Q37: Do the AG CCC cash value scales shown in the graphs on slides 51 through 56 meet the smoothness test?

A37: *Yes, AG CCC scales in the graphs meet the requirements of the smoothness test.*

Q38: What is meant by managing deficiency reserves?

A38: *Managing deficiency reserve means that X-factors should be optimized to ensure the least amount of deficiency reserves is required for the product. The product design is already capital intensive, so adding deficiency reserves only makes it more difficult to achieve profit goals.*

Q39: Regarding the prefunding limit, do incremental death benefits exclude 7702 corridor?

A39: *If the ROP benefit returned would require that you raise the face amount to comply with 7702, then you would have an increasing face amount at those durations (generally later in the policy when the CV is large). You would end up with a cyclical effect as the CVs change, the NSP changes, causing a different face increase required, etc. Talk to your tax advisor, but it may be easier not to offer that age.*

Q40: Have you seen possible rate of returns for ROP benefit vs. additional ROP premium under AG CCC?

A40: *Some carriers have used an IRR calculation in marketing ROP term. The IRR is based on the premium for a term product, the additional premium for the ROP benefit, and the interest rate used to accumulate the difference between these rates to the ROP payout at the end of the level premium period (sort of a buy term and invest the difference scenario). In general, one would expect the premium for the ROP benefit to increase, which in theory would result in lower IRR. The amount of the decrease will depend on the particulars of the design, and is likely to vary between the companies.*

Q41: What are you hearing from carriers regarding their expected actions at year end? Close out the product? Reprice?

A41: *Each carrier is making different decisions about the product for various reasons. We have heard of more companies looking to see if they can make this work than of those planning to close out their products, but that is certainly subject to change.*

Q42: Do reserves only increase for companies who have NOT been calculating integrated reserves?

A42: *Reserves will increase for all parties when the endowment benefit itself has increased, integrated reserve or not.*

Q43: Are you finding that if you have a policy fee, you need to have cash values that vary by size in order to comply with AG CCC?

A43: *Cash values should be checked due to the fact that the policy fee affects the per unit values in the calculation. It may be possible to find a scale that works for face amounts within a band, but rigorous testing would be required.*

Q44: For the 20 year AG CCC minimum cash value calculations shown on slides 54 through 56, what are the assumptions for interest, mortality and premium?

A44: *2001 CSO ultimate, male, smoker distinct, 5% interest. Premiums are $1.50 per unit best preferred, $2.86 for standard NT, and $6.36 for standard tobacco.*