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Return of Premium Term—**Implications of a New Actuarial Guideline**

by Dominique Lebel

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Return of Premium (ROP) Term is one of the hot products in the life insurance market for several reasons:

- ROP Term is easy for consumers and producers to understand.
- Sales pitches such as "money-back term," "did you know that very few policies mature as death claims," and "win-win: insurance protection if you need it, return of premiums paid if you don't," resonate with buyers.
- Quoted after tax rates of return are often higher than alternative investments (e.g., bank certificates of deposit).
- The additional premium for ROP Term translates into additional commissions for the producer.
- Return of premium feature makes the product work for a variety of strategic sales situations such as mortgage funding, college funding, alimony funding, key-man and buy-sell.

ROP Term typically returns increasing percentages of premiums paid if the policy is lapsed. The percentages usually grade from 0 percent at issue to 100 percent at the end of the level term period. The percentages can vary significantly by insurer based on how each insurer interprets the Standard Nonforfeiture Law. In fact, a few companies do not provide any interim cash values; only a full return of premium at the end of the level term period.

A new actuarial guideline, AG XLV (formerly known as AG CCC), was adopted in the fall of 2008 by the NAIC. AG XLV sets guidelines for minimum cash values for ROP Term policy forms filed after Dec. 31, 2008 and policies issued after Dec. 31, 2009.

Under AG XLV, cash values prior to the end of the level term period will generally need to be increased for most current ROP Term products (for some products, current cash values at certain durations could be decreased, but overall, cash values under AG XLV are generally higher than current cash values). This general increase in cash values will likely necessitate an increase in premium rates. The higher the lapse rates assumed, the greater the impact on premium rates. For example, since worksite products generally have higher lapse rates than products sold in other distribution channels, the impact on worksite ROP Term premium rates may be significant.

AG XLV will have other consequences. For example:

- Currently, due to a common interpretation of the Standard Nonforfeiture Law, many ROP Term products have interim cash values that do not vary by underwriting class. AG XLV will cause ROP Term products to have cash values that vary by underwriting class (i.e., by issue age, smoking class, etc.).
- AG XLV has clarified how interim minimum cash values should be calculated for ROP Term products, which should make ROP Term products available in all states. Prior to AG XLV, state regulators interpreted the Standard Nonforfeiture Law differently in respect to ROP Term minimum cash values. This made it difficult to get ROP Term policy forms approved in all states.
- Some companies designed ROP Term products to take advantage of uncertainties in the Standard Nonforfeiture Law in relation to ROP Term products. ROP rider and indeterminate premium designs are two such examples. AG XLV includes language that eliminates the benefits obtained from ROP rider and indeterminate designs. As a result, fully guaranteed integrated designs may replace these designs.

As outlined above, the implications of AG XLV are numerous. Time is short for providers to have competitive products in place for year-end 2009.