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Underwriting Juveniles for Large Cases: The Issue Grows More Complex

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EXECUTIVE SUMMARY

Life insurance for juveniles has been a fairly simple proposition. Most insurers offer a Juvenile Coverage rider to a parent's policy for a nominal face amount and charge. Others offer stand-alone low-face whole life policies. Coverage traditionally has been for final expense (the rider) or as a primer for the child's savings (whole life).

But the market is growing more complicated, with parents or grandparents now seeking multimillion-dollar policies for their (grand)children. How are companies responding, especially in light of increased consumer (and producer) demand, and what are the risks?

The author outlines some considerations.

Many companies offer low amounts of coverage for minors through a rider attached to an adult policy or a stand-alone whole life policy. A growing trend we have witnessed through discussions with clients and in our own facultative shop is an increase in high-face applications on children. While still infrequent, we are beginning to see applications for $5 million, $10 million or even more. This business is small relative to total volume but the trend does raise some questions.

TIMES HAVE CHANGED

Life insurance for minors traditionally is sold to provide final expense coverage for an unanticipated death or to help create a nest egg for the child to use in early adulthood. Often the savings element in whole life policies is marketed as a tool to help finance college education. But the product design has not kept up with the times: with annual expenses at many colleges reaching up to $100,000, the cash/surrender value of a $150,000 whole life policy may not cover the first-year tuition and expenses.

We reviewed some recent policy illustrations to examine cash values at age 18 (Figure 1):

- About $80,000 on a $500,000 15-pay whole life policy for a 3-year-old girl

- About $115,000 on a $1 million 10-pay whole life policy for a 5-year-old boy

Based on the illustrations, the cash value $500,000 policy likely would fall short of completely financing a traditional, four-year college education today, whereas the $1 million coverage could provide sufficient funds for all but the most selective universities.

Other factors certainly play a role in the trend, however:

Gifting. The IRS allows an individual to gift assets up to $14,000 ($28,000 for a couple) to another person without causing a taxable event. The gifting of premium into a secure, large risk/savings instrument can be attractive, especially compared to other savings vehicles.

For the high-income segment who may have maximized their own tax-favored vehicles (jumbo life coverage, maximum contributions to 401(k) and other retirement vehicle savings, etc.),

Figure 1
A Comparison of Two Whole Life Policies

Characteristics Insured	Policy A 3-year-old girl	Policy B 5-year-old boy
Policy	15-pay whole life	10-pay whole life
Initial Face Amount	$500,000	$974,219
Annual Premium	$3,600	$12,000
Paid Up at Age...	17	18
Cash Value, Age 18	$72,986	$116,312
Face Amount, Age 18	~ $1 million	~ $1.2 million

The illustrated policies assume dividends finance paid up additions, hence the increase in death benefits. Case values represent guaranteed values.

such policies on their children may be an attractive wealth transfer option.

Tax benefits. The cash and surrender values of whole life insurance have numerous tax advantages over many investment alternatives. Policy loans trigger no tax event as long as the loan is repaid. And of course death benefits pass to beneficiaries tax-free.

Guaranteed insurability. Permanent products allow the parents to lock in a child's insurability based on current health status. In addition, many policies, such as those in Figure 1, are paid up at age 18 to maximize the gifting/benefit balance.

International dollar business. Customers from overseas value the security of a hard-currency-denominated instrument issued by a highly rated life insurer. In Canada we see more clients from Asia purchasing permanent policies with CA$5 million or more in face amount. Similar trends exist in the United States, especially with wealthy clients from Latin America.

Carrier participation. Demand cannot be met without supply, and some life insurers have signaled at least some willingness to offer high-face policies on minors.

CHALLENGES ARISE

With the exception of infants, we expect children to exhibit favorable mortality. In theory then, high-face, high-premium life insurance policies on minors may be a profitable business. However, some issues persist.

Insurance experience. As an industry, we do not have adequate experience to underwrite or price such products accurately. Our previous product offering has been very low face amount with a very conservative premium rate. Large cases are new territory for many companies.

Adult vs. juvenile underwriting. Most large-face policies are designed to be fully underwritten on adult applicants. An insurer is unlikely to require blood, urine, attending physician statement (APS), rest/stress EKGs, etc. from a child. In any case such test results likely would not be too informative: NTPro-BNP is likely not a relevant risk marker for a fifth grader.

Causes of death. Children and adults die from different causes. Death from age 5 to 25 is primarily driven by accidents (*http://www.nlm.nih.gov/medlineplus/ency/article/001915.htm*). According to the National Institutes of Health (NIH), death rates among U.S. children fall significantly after infancy, and rise around age 15 from accidents, suicide and homicide.

Note that NIH data is population-based, and data from other countries may not be as readily available or credible for International Dollar Business.

Definition of insurance. A key consideration in the definition of insurance is insurable interest. If a policy fails the insurable interest test, is it in fact "insurance"? Risk transfer remains the defining test in distinguishing between life insurance and an endowment.

CARRIER RESPONSE

We recently conducted an informal poll of client chief underwriters on this subject. The consensus is that companies are seeing more of such cases and the trend is raising interest and concern.

However, approaches vary, from retaining the traditional approach (perhaps raising the coverage limits to reflect today's education costs) to being fairly comfortable with writing higher-face policies on minors. Some companies will not consider such coverage unless the applicant's parent(s) are covered with the company; others appear willing to issue policies without this prerequisite. Some insurers may limit coverage amounts as a percent of the parent's in-force. Other carriers may match the parent's face amount dollar for dollar.

REINSURER INVOLVEMENT

SCOR Global Life Americas continues to monitor this development and assess the trend's implications for the industry. If your company is seeing an increase in such application activity, please feel free to contact any of SCOR's underwriters for consultation. ■

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