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Term Conversion Survey Results

By Kyle Proebsting and Lindsay Meisinger

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In 2014, the SOA Product Development and Reinsurance Sections, along with the Committee for Life Insurance Research engaged Reinsurance Group of America (RGA) to undertake a research project on term conversion practices and mortality experience.

The project was split into two phases:

- Phase 1 is an assumption survey which is focused on product features and conversion practices.
- Phase 2 is an experience analysis of level term business as it transitions from the term policy into the converted permanent policy.

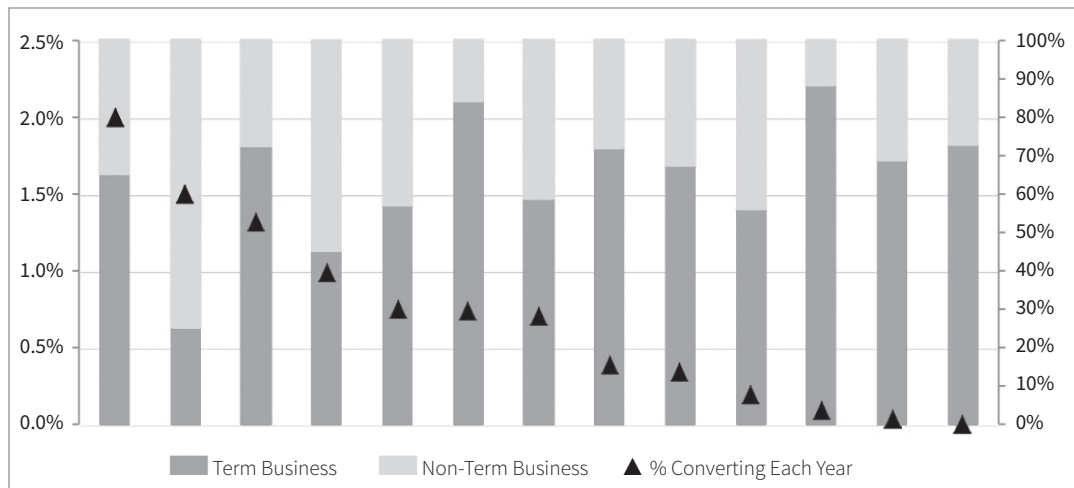
The Phase 1 survey was completed by 21 companies that made up 52 percent of the 2013 term sales in the market. This article summarizes some interesting findings from the survey. The complete survey report can be found at <https://www.soa.org/Research/Research-Projects/Life-Insurance/2015-survey-conversion-assumptions.aspx>. Throughout this article, graphs are pulled directly from the complete survey report for ease of reference for the reader.

COMPANY INFORMATION

The first section of the survey focused on sales distributions of the participating companies. On average, more than half of the survey respondents' sales in 2013 came from term policies, and approximately one-third of their in-force business is made up of term policies. Approximately 1.1 percent of respondents' term policies converted to permanent business each year. The phase 1 survey results were presented at the 2015 SOA Life and Annuity Symposium which included audience participation via polling questions. These polling questions helped to give further insight

Graph 1

Face Amount Issued in 2013
Companies Providing % of Policies Converging Each Year
Ordered by % Converting Each Year



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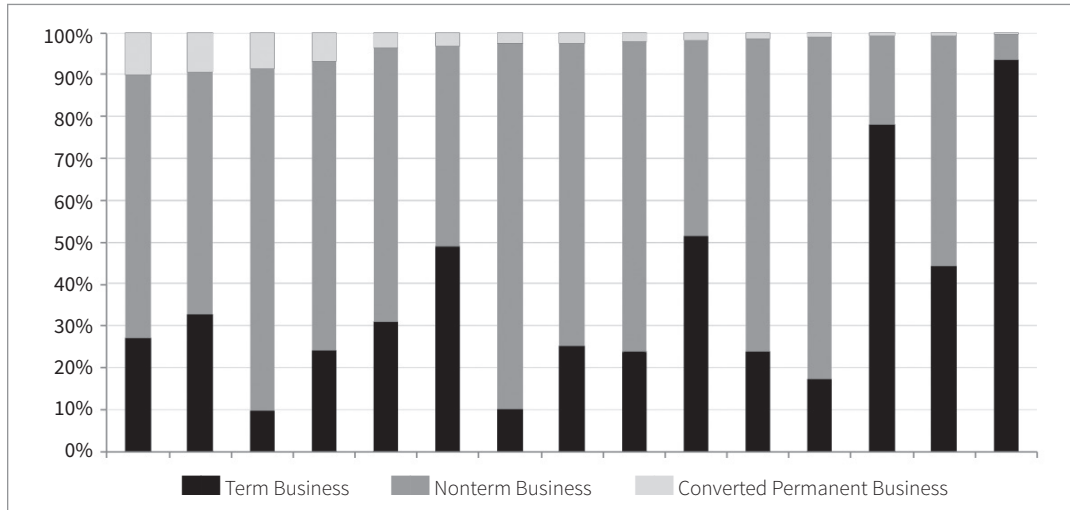
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into the conversion process. The results of the audience polling generally supported the previously mentioned statistic as approximately 61 percent of the attendees indicated that between 0.5 and 3 percent of their term policies have converted to permanent business annually.

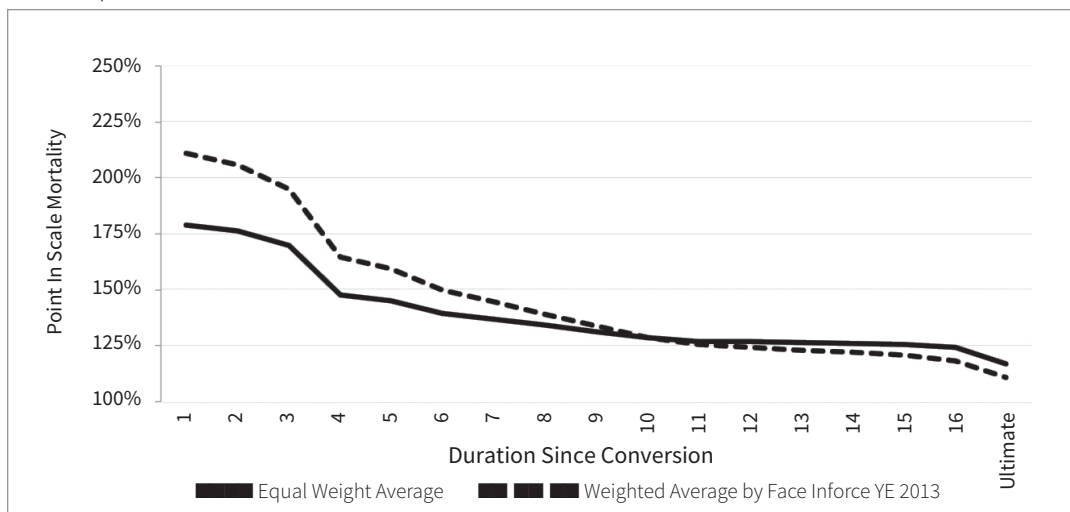
When looking at the data (Graph 1) by policies issued in 2013 supplied by companies who provided a percentage of business converting each year, note the range of converting business is between zero and three percent. Furthermore, the information which has been presented by conversion percentage from largest to smallest does not indicate an apparent correlation between business mix and conversion percentage.

The proportion of in-force policies tells a very similar story in Graph 7. Companies were asked to provide three data points as of year-end 2013, including term business, non-converted permanent business (nonterm), and permanent business converted from term (converted permanent). The mix of in-force business attributed to converted permanent policies ranges from zero to 10 percent of the total in-force business for any given company who responded with each of three data points requested. For some companies, Graph 7 shows the overall percent of converted policies in force is not an immaterial portion of in-force business and should not be overlooked.

Graph 7
Policies Inforce Year End 2013



Graph 13
Multiple of Best Estimate Mortality Expectation for Converted Business
By Duration Since Conversion
All Companies



CONVERSION BEST ESTIMATE MORTALITY

The survey asked respondents to provide the best estimate mortality expectation for converted business as a percentage of non-converted permanent business issued at the same time of the original term policy, referred to as Point-in-Scale Mortality (PISM). For example, a term policy that converts

in the 8th duration is compared to an underwritten permanent policy that is in its 8th duration.

Seventeen of 21 companies answered this question. Twelve companies provided a flat multiple of PISM. These multiples ranged from 100 percent, meaning no additional mortality for converted business to 200 percent, or two times the mortality for converted business as

a percentage of non-converted business.

The remaining five companies provided mortality multiples which varied by duration since conversion. The multiples started anywhere from 200 percent to 500 percent (well above the flat multiples provided by the other 12 companies) grading down to approximately 150 percent or 100 percent, 10 to 15

years after the policy converted. This indicates that some companies see anti-selective behavior of conversions that is more prominent immediately after conversion and wears off in the later policy durations since the conversion.

The results of all companies were averaged by equal weight as well as weighted by face amount totals as of year-end 2013, shown in Graph 13.

Both averages show the same assumption trend in mortality since conversion: higher mortality immediately upon conversions as a percentage of PISM, grading down to little or no additional mortality after at least 15 years since conversion.

CONVERSION PROCESS

The conversion process, consisting of topics relating to administration, auditing and experience studies was also surveyed. While three of the 21 respondents indicated that conversions are coded as lapses or surrenders, the remaining 18 companies indicated that conversions are identified by their own individual code in company systems. Once the policy has been converted to a permanent plan, it can be coded as in force or new business. Eighteen of the 19 companies who responded indicated that they track converted policies as new business. Since conversions are technically a continuation of another contract, this administration process may be contributing to the fact that only nine of the 21 companies indicated that they could identify conversion on permanent plans as well as link the permanent

plan back to the original term policy. Some of the companies expressed interest in improving this process.

Conversions are generally administered on the same systems as their permanent and term policies. While every company indicated that conversions and permanent policies are administered together, only 19 of the 21 respondents indicated that conversions and term policies are administered on the same system. For the two remaining companies the term and conversion policies would be administered on a different system depending on what type of product the policy would be converted.

The survey also asked each company if they had the ability to audit their conversion process. Only 10 of the 21 companies had the ability to audit and only three of those companies who audit are doing so on a regular basis (at least annually). Based on the findings of a conversion audit, two companies responded that they have enacted changes. The desire to improve current auditing processes tended to be a general theme among the respondents' additional comments.

Chart 18

| Conversion Philosophy | |
|--|-----------|
| Encourage Conversions | Responses |
| At any time to every insured | 8 |
| At certain points in time for every insured | 4 |
| At certain points in time to certain insured | 3 |
| We do not encourage conversions ever | 4 |
| Not sure | 2 |

When asked about conversion mortality studies, 16 companies indicated that they are able to look at conversions separately from other data, six of which can review their mortality studies with and without conversions. Moreover, 13 of the 16 companies with the ability to look at conversions separately do perform separate conversion mortality studies.

CONVERSION PHILOSOPHY

When asked whether or not conversions were encouraged, only four of the 21 companies indicated that they are not encouraged, while two companies were unsure. The remaining breakdown in Chart 18 shows eight companies encouraging conversions to any insured at any time, four companies encouraging conversions to any insured at certain times, and three companies encouraging conversions to certain insured at certain times.

This seemed to be the general consensus at the 2015 SOA LAS presentation as well, as 72 percent of the polling respondents fell into one of the three encouragement camps and only 9 percent claimed their company does not encourage conversion.

One of the hottest topics in the industry today is the idea and implementation of predictive modeling. When asked if predictive modeling is currently used to target conversions no company admitted to be doing so, however, two companies indicated that they have either begun to investigate it as a possibility or potentially will consider it in the future.

Chart 19 shows the majority of the survey respondents indicated that they build the cost of conversion into the term policy either implicitly or explicitly.

Chart 19

| Conversion Philosophy | |
|--|-----------|
| Cost of Conversions | Responses |
| Implicitly built into the term policy | 5 |
| Explicitly built into the term policy | 7 |
| Implicitly built into the permanent policy | 5 |
| Explicitly built into the permanent policy | 2 |
| Not built into either term or permanent policy | 1 |
| Conversion has no cost | 1 |

Implicitly refers potentially to embedding the cost into the mortality assumption and explicitly refers to potentially per policy or per unit additional costs specific to conversions charged in pricing. Conversely and interestingly enough, at the 2015 SOA LAS presentation, most polling responses indicated that they believed the cost of conversion would be built into the permanent policy (48 percent total), not the term policy as the survey indicated.

CONVERSION REINSURANCE

The survey concluded with a section on reinsurance of converted policies. Almost all

of participating companies (18/20) responded that they reinsure conversions. Two companies out of 17 respondents recapture the conversions and cede them to the permanent pool, while 15 of the companies indicated the conversions stay with the original reinsurance pool regardless of permanent pool participation.

Slightly more than half of the companies (10/18) indicated they are paying separate rates for conversions regardless of participation in the permanent pool. These companies may

recognize the conversion policies should be treated differently than the other reinsured permanent policies. Five (5/18) respondents pay permanent point-in-scale rates upon conversion to reinsurers that are in both the permanent and term pools. The remaining responses are shown in Chart 20.

At the Life and Annuity Symposium a polling question was asked on the structure of reinsurance premiums. The largest portion of respondents, 39 percent, answered that they pay permanent point-in-scale rates. This differed from the survey report results above, where most respondents indicated

Chart 20

| Conversion Reinsurance | |
|--|-----------|
| Structure of Reinsurance on Converted Policies | Responses |
| We pay separate rates for conversion regardless of permanent pool participants | 10 |
| Reinsurers that are not in existing permanent pool are paid based on the reinsurance terms of the original term policy as if it didn't convert | 1 |
| Reinsurers that are in both the term and permanent pools are paid permanent point in scale rates upon conversion | 5 |
| We do combinations of the above depending on the reinsurer | 2 |

paying separate rates for conversions.

PHASE 2


As indicated in the survey, most companies are identifying the conversions in their administration systems, but the issue is tying the permanent policy back to the original term policy. This is the biggest challenge facing Phase 2 of this project in completing a mortality study on converted business when original issue date or durations since conversion is lost.

A goal of the Phase 2 Experience Analysis portion of this research project is to exam-

ine the mortality of converted business. It will be interesting to compare Graph 13 from the Conversion Best Estimate Mortality Section to the actual experience study results as they become available.

The remaining focus of Phase 2 is to analyze the level term business as it transitions into a converted policy. Conversion rates will be compared to the underlying conversion privileges where available.

This analysis is currently ongoing, but a first look at results will be presented at the SOA Annual Meeting in October. ■



Kyle Proebsting, FSA, MAAA, is senior assistant actuary at RGA in Chesterfield, Mo. He can be reached at kproebsting@rgare.com.



Lindsay Meisinger, FSA, MAAA, is an associate actuary at RGA in Chesterfield, Mo. She can be reached at lmeisinger@rgare.com.