Small Talk Newsletter

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A New Platform for Universal Life

by Karen Rudolph

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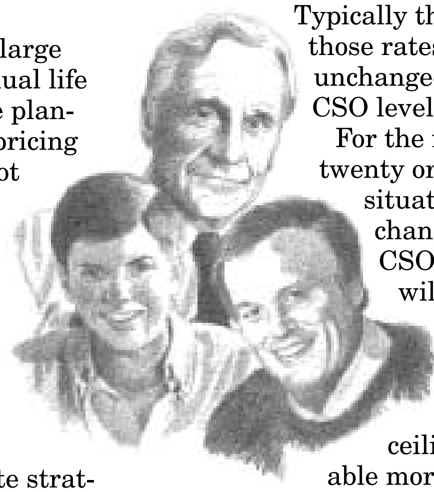
Companies writing large volumes of individual life insurance must be planning in advance for a repricing of the entire portfolio. Not only is universal life affected, but all types of traditional and term insurance as well. Within the company, the product development cycle will be tested as never before. Planning, constructive communications, accurate strategy and current knowledge of the company's experience factors will be key to successful portfolio re-engineering. This newsletter addresses universal life products in general.



Mortality Margins

Companies in the universal life market have historically introduced new products reflecting reductions in current mortality charges or new, more preferred risk classes. Typically the ceiling on those rates remained unchanged at the 1980 CSO levels.

For the first time in twenty or so years, that situation is about to change. The 2001 CSO Ultimate table will eventually take the place of the 1980 CSO table as the effective ceiling on reasonable mortality charges for standard risks.

Let's look at what this could mean for a sample universal life plan with attained age-based cost of insurance charges. The graph below depicts an assumed level of experience (bold solid line), current insurance charge rates for the sample plan (dotted line) and the

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In This Issue

Chairperson's Corner: The Catastrophic Life Reinsurance Coverage Decision after 9/11

by R. Dale Hall

A few months ago, CBS broadcast their primetime special "9/11", which commemorated the six-month anniversary of the tragic events of September 11th, 2001. The program showed the world for the first time footage taped in and around the World Trade Center as a French film crew followed New York City firefighters through the events of that morning. One of the many amazing things that struck me while watching that special was the incredible amount of dust, darkness and confusion that occurred when Tower 1 collapsed to the ground. Hiding behind a car parked on the street and being shielded by one of the captains of the firefighting team, one of the photographers caught on film the whirlwind storm that occurred as the building imploded just a few hundred feet away.

"Whirlwind" might also be the correct adjective to describe the activity surrounding the changes going on in the catastrophic life reinsurance market in the past six months. As traditional reinsurance carriers and pools try to determine how to react and adapt to new types of catastrophic risk, many direct writing insurance companies are facing new decisions. Should they continue with their current coverages even if the parameters of the coverage are changing? Is the cost of the coverage too much given the probability of catastrophe? What other options are available?

An important consideration in determining what type of catastrophic coverage a company

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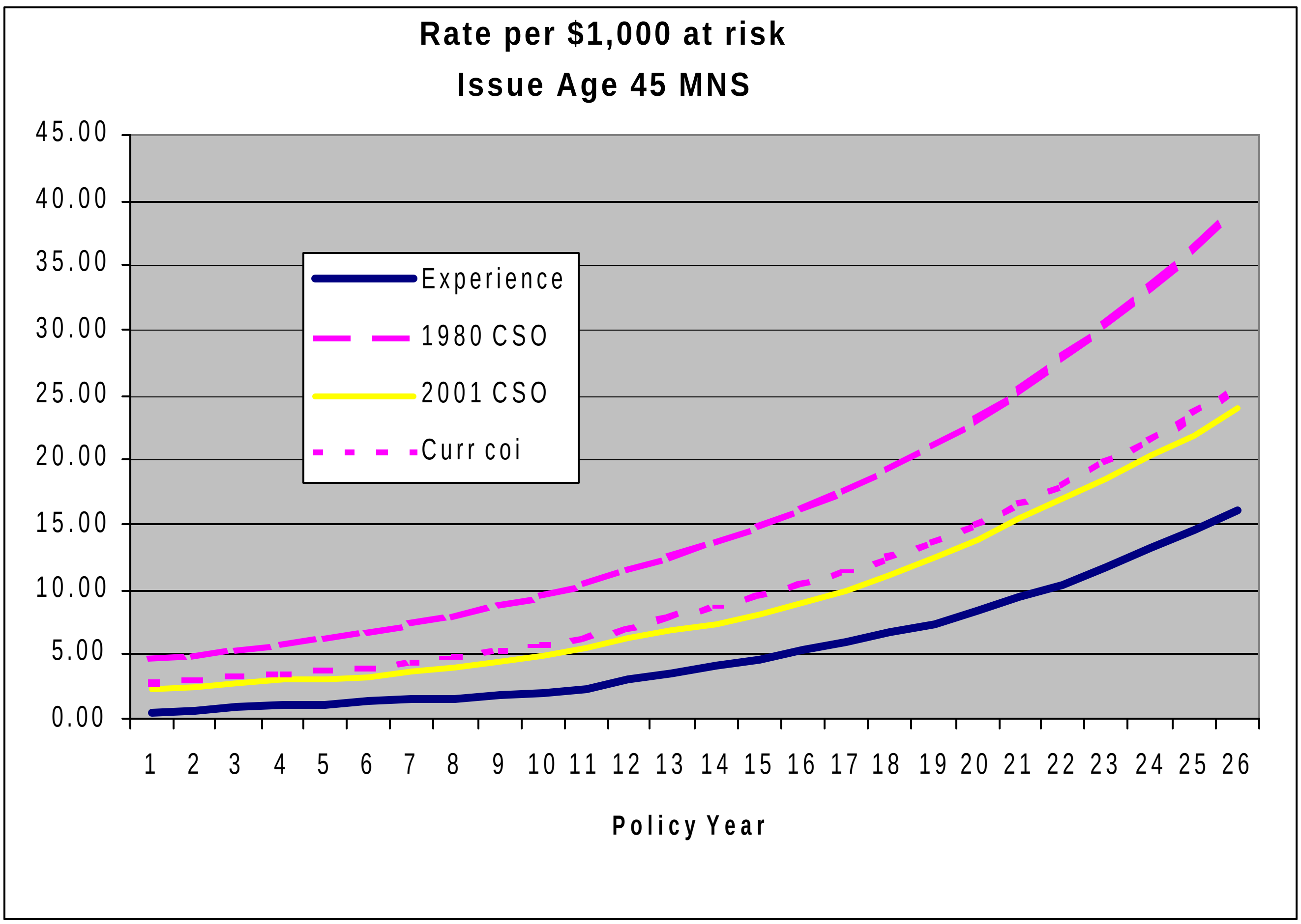
current COI and actual experience are a source of profit for the company. The 1980 CSO rates offer a margin for adverse deviation above the current rates and represent the highest level to which the insurance charges can be raised.

The 2001 CSO Ultimate (thin solid line) is based on insured risk mortality experience from 1990-95. Particularly for males, ultimate rates are considerably lower than current 1980 CSO ultimate ceiling rates. For a plan like that depicted, the new ceiling is at or below the current mortality charge rates.



For this plan, the guaranteed mortality charges take on a new, lower rate while the current mortality charges need to be repriced at a level below the 2001 CSO Ultimate but above experience levels. In any case, the profit margin from mortality charges has been squeezed to minimal levels, assuming the mortality experience underlying the plan remains unchanged. This situation becomes even more apparent for products where the COI charge is designed using a reverse select and ultimate structure. Product loads and charges will need to be designed such that the profit margins lost to the new mortality basis can be recovered elsewhere.

Illustrations and Premium Limits

The NAIC Life Insurance Illustrations Model Regulation requires a basic illustration to consist of a numeric summary of the death benefits and values on three bases: (a) policy guarantees, (b) Insurer's illustrated scale and (c) Insurer's illustrated scale with non-guaranteed elements at an average of the guaranteed rates and the illustrated rates. To date, only the illustrated scales have been subject to change. With the adoption of the new valuation table and its eventual recognition as the maximum level of reasonable mortality charges by the tax code definition of life insurance, the guaranteed illustration and corresponding 7702 maximum premium limits will change.

Here is an example. The policy illustrated below is $100,000 specified amount with a $60 policy load, assessed monthly. The guaranteed interest rate is 6% in the first year, 4% in renewal years. The issue age is 45 and four risk classes are examined.

The two numbers listed under 1980 CSO and 2001 CSO are (i) the guaranteed maturity premium or GMP, i.e. that level premium paid at issue and annually thereafter which matures the policy for the specified amount (at attained age 95 in this case) based on contractual guarantees of mortality, interest, loads and charges and (ii) the 20th year cash value, i.e. the cash value at attained age 65.

	GMP / Cash Value PY 20		
Risk	1980 CSO	2001 CSO	Reduction
45 MNS	$1,904/$37,954	$1,559/$33,056	18%/13%
45 MS	$2,504/$41,017	$2,022/$36,433	19%/11%
45 FNS	$1,597/$32,579	$1,279/$26,384	20%/19%
45 FS	$1,875/$33,770	$1,761/$32,117	6%/ 5%

Three of the four risk classes demonstrate a material reduction (up to 20%) in the amount of premium necessary to mature the contact. Likewise, there is a corresponding reduction in the policy cash values. Female smoker risks will see the least amount of change under the new limits.

The tax code definition of life insurance defines a guideline level premium similar to a GMP. These tax code guideline premium limits will also experience reductions under the 2001 CSO basis. An insurer's premium receipts per $1,000 of specified amount will be placed under a lower limit than before for universal life plans following guideline premium/cash value accumulation test requirements. Recovery of this premium revenue will be the focus of the marketing division since agent's commissions will also be limited in dollars per $1,000 of coverage.

Conclusion

Product structure for flexible premium universal life plans with fixed interest guarantees are likely to change as the 2001 CSO is phased in as the required statutory and tax valuation table. Compared to current portfolio universal life products:

- Mortality margins will become smaller
- Premium limits will become smaller per unit of specified amount
- Surrender charge limits may decline as the new tables reduce the maximum first year allowable charge per unit
- Statutory and Tax basis reserves will change

Advance planning, constructive communications and a clear vision of the desired product portfolio and profit objectives will facilitate the company's success in moving to the new 2001 CSO platform.

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