Preneed Mortality Road to 26

By James N. Van Elsen

On Jan. 1, 2009, the 2001 CSO becomes the mandatory mortality table for valuation and nonforfeiture purposes for individual life insurance. There has been much activity in developing preferred mortality variations of the 2001 CSO. At the other end of the spectrum, however, is preneed life insurance. The 2001 CSO—as documented in a September 2007 report from the SOA's Preneed Experience Team—is inadequate for this business.

The Problem

As it currently stands, preneed companies will have to convert all their new business to the 2001 CSO at the beginning of 2009. Most will have to set up additional reserves in order to maintain adequate reserves. One approach would be to treat this business as "substandard" and use a multiple of the 2001 CSO as the valuation and nonforfeiture table. This may be satisfactory for statutory reporting. For tax purposes, however, IRC §807(e)(5)(D) limits substandard business to be no more than 10 percent of the life insurance inforce. For many companies that write preneed life insurance, this business represents 100 percent of their business. In this situation, much, if not all, the extra reserves would be non-deductible.

The second solution would be to voluntarily set up additional reserves. Again, this is satisfactory for statutory reporting, but would be likely non-deductible for tax purposes. As such, in July 2004, the preneed life insurance companies began to search for a more acceptable approach to provide for the higher expected mortality of their business.

Phase 1—NAIC Model Regulation

In March 2007, Jay Vadiveloo made a presentation to the National Association of Insurance Commissioners' (NAIC) Life & Health Actuarial Task Force (LHATF) regarding progress on the Society of Actuaries' (SOA) preneed mortality study. In that presentation he pointed out the similarity of ultimate preneed experience mortality to that of the 1980 CSO. This is discussed in the June 2007 issue of *Small Talk* in an article written by Mark Birdsall. With two-thirds of the preneed business being single premium whole life, and almost all the rest being limited payment whole life, this results in the 1980 CSO being a very good proxy for the preneed life insurance mortality in calculating statutory reserves.

A new model regulation has been developed which mandates the use of the 1980 CSO for preneed business issued on or after Jan. 1, 2009. This will affect both valuation and nonforfeiture calculations. Preneed life insurance is defined in the regulation as:

> "any life insurance policy or certificate that is issued in combination with, in support of, with an assignment to, or as a guarantee for a prearrangement agreement for goods and services to be provided at the time of and immediately following the death of the insured. Goods and services may include, but are not limited to embalming, cremation, body preparation, viewing or visitation, coffin or urn, memorial stone and transportation of the deceased. The status of the policy or contract as preneed insurance is determined at the time of issue in accordance with the policy form filing."

The model regulation has a drafting note which suggests that individual states may wish to input their own definition. It also provides for alternative definitions. It is important to note that this regulation does not apply to other forms of limited underwriting business, such as final expense life insurance. This was due to the difficulty in defining the limited underwriting business, and the desire to not affect other life insurance products. Also, the SOA mortality study was of preneed life insurance only. This experience is not appropriate for determining a mortality basis for any other life insurance product. It remains an open issue to find an appropriate valuation mortality basis for life insurance products other than preneed with higher expected mortality than the 2001 CSO.

The model regulation also has a provision for a transition period. Through the end of 2011, the 2001 CSO will be permitted to be used for valuation and nonforfeiture purposes for preneed life insurance. This was put into the regulation to allow companies which have already converted to the 2001 CSO adequate time to change their products. In order to take advantage of this transition, however, companies must annually submit a notice to their domiciliary commissioner. This notice must:

1. Provide a complete list of preneed policy forms which use the 2001 CSO.
2. Contain a certification from the appointed actuary that adequate reserves are maintained for these policies.
3. Provide supporting information for the appointed actuary certification.

The model regulation was adopted by LHATF by conference call on Feb. 7, 2008. It was adopted unanimously by the NAIC as a model regulation on March 31, 2008.

Phase 2—Road to 26 States

In order to become the prevailing commissioners' mortality table for preneed life insurance, it will be necessary for this regulation to be adopted by 26 states. Of great concern to all companies that write preneed life insurance are the consequences of not accomplishing this by the end of 2008. If this is not accomplished, the companies will withstand the taxation penalty as described in the section of this article entitled "The Problem." Even worse, however, is what would happen in those states that adopt the regulation until 26 states adopt. These companies would be faced with the situation where the policies which they write in conformity with the states' nonforfeiture laws no longer qualify as life insurance. As such, the companies that write this business are working very hard to get the new regulation adopted in at least 26 states by the end of 2008.

What about the states that do not adopt the regulation? If at least 26 states do adopt it, there is no problem. Companies could voluntarily choose to carry additional reserves and higher nonforfeiture values. It would be an easy demonstration that the 1980 CSO will exceed the minimum state requirements.

Phase 3—New Preneed Mortality Table

The SOA's Preneed Experience Team has completed their work and has turned it over to the American Academy of Actuaries' (AAA) Preneed Mortality Working Group, headed by Carol Salomone. This working group is in the process of turning the experience data provided by the SOA into a valuation table for preneed mortality. It is anticipated that this will eventually result in a new minimum standard for valuation and nonforfeiture for preneed life insurance. Until that time, preneed life insurance will continue to use the 1980 CSO.

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