



SOCIETY OF ACTUARIES

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## *Activities of the Small Face Amount Working Group*

*by Rick Campbell*

### I. Introduction

The purpose of this article to provide interested parties with a summary of the activities of the Small Policy Consortium (the "Consortium"), a group of life insurance companies, each of which writes small face amount life insurance policies. The Consortium was formed in response to the actions of some insurance regulators who questioned the benefits of small face amount products. Initially, the concerns of regulators were expressed in an NAIC resolution (the "Small Policy Resolution") signed by representatives of over 40 state insurance departments in June of 2000. Unfortunately, the resolution tied small face amount policies to products that are underwritten using race-based guidelines.

In a meeting of the NAIC Home Service Working Group held on June 11, 2000, then Kentucky Insurance Commissioner George Nichols, who at that time was also serving as NAIC President, announced the formation of a new NAIC committee to study the economic value of small face amount life insurance policies (the "Small Face Amount Working Group" or the "Working Group"). He explained that the officers of the NAIC had drafted the Small Policy Resolution to ensure that small face amount policies would be examined on a national level. He added that the NAIC was not looking to shut down companies that write the products. Rather, he noted that the NAIC had a priority to protect policyholders who may have purchased "upside down policies," i.e., those policies where premiums paid over a number of years exceed face amount.

On the issue of whether small face amount policies were linked with race-based underwritten policies, Commissioner Nichols stated that he had seen several race-based products and that all of them had a small face amount. The Consortium made the point with Commissioner Nichols (and with others) that while some race-based policies may have small face amounts, not every small face amount policy has a race-based premium. The Consortium spent a great deal of time and effort over several months separating these two issues.

In early July of 2000, the Consortium decided to formally organize using the National Alliance of Life Companies (the "NALC") as its primary resource for sharing of information and coordination of activities. The NALC members realized that the Consortium's efforts need to span across association lines. Therefore, Consortium members were sought from the LIC and the ACLI and support was requested from each of the Associations.

During the remainder of the Summer, representatives of the Consortium visited with regulators and worked to ensure that its views would be represented at the first meeting of the Small Face Amount Working Group to be held during the September meeting of the NAIC.

### II. The First Meeting of The Working Group

On September 12, 2000, the Small Face Amount Working Group held its organizational meeting. Pennsylvania Insurance Commissioner Diane Koken chaired the meeting, and asked commis-

sioner George Nichols to make an opening statement. In his remarks, Commissioner Nichols observed that the NAIC decided to take up the study of small face amount policies where the Home Service Committee left off. He acknowledged that not all small face amount policies have race-based premiums (this was the Consortium's first victory), and announced that the two issues were independent of one another and would be addressed in different forums. He suggested that the Small Face Amount Working Group should complete its work by June, 2001.

The Working Group then discussed the charge given to it by the NAIC. That charge is as follows:

[The Working Group should] complete a regulatory analysis of the small face amount (less than \$15,000 face value) life insurance business, in all its various distribution forms, with an emphasis in this analysis on the overriding goal of fair policyholder treatment, not only in terms of market conduct, such as appropriate disclosures, but also addressing the issue of fair value for the premiums paid, and any other related issues. The analysis shall result in detailed proposals for reform by the Summer National Meeting.

Following the comments of Commissioner Nichols, the Working Group agreed that it would not include in its analysis credit insurance, escheat issues, the sale of multiple policies, and suitability. The Working Group then planned

an interim meeting for the month of October. The purpose of the interim meeting was to hear a report from the industry about small face amount policies and the market-place in which they are sold.

For the next several weeks, members of the Consortium prepared for the interim meeting. Topics were assigned and speakers were recruited to address various aspects of the industry and its different distribution systems.

### III. The October 2000 Interim Meeting

On October 26, 2000, the Working Group held its first interim meeting. The industry provided 11 speakers for the event. Presentations were made on actuarial issues, final expense policies, fraternal organizations, preneed insurance, and the home service industry. The meeting lasted an entire day and there were numerous questions asked of the industry by regulators.

Subsequently, the industry and the Working Group agreed upon the language of 28 questions that had been asked by regulators during the interim meeting. The industry responded to a number of the questions in a letter, dated November 22, 2000, to Commissioners Koken and Nichols, who co-chaired the interim meeting. The letter contained a general overview of small face amount products, and included correspondence from Alex Zeid (the Consortium's Independent Actuary) explaining how cumulative premiums can exceed the face amount of some life insurance policies. The Consortium spent considerable time working on the November 22nd letter and providing information to regulators in a manner that was responsive to their inquiries.

Following the October interim meeting, the Consortium turned its

attention to preparation for the next meeting of the Working Group, which was to be held in conjunction with the Winter National Meeting of the NAIC.

### IV. The December 2000 Meeting of The Working Group

On December 5, 2000, the Working Group held its second meeting. The gathering was chaired by Commissioner Nichols, who announced his appointment of South Carolina Insurance Director Ernst Csiszar and Arkansas Insurance Commissioner Mike Pickens as co-chairs of the Working Group. Commissioner Nichols also announced that he had written a letter to the American Academy of Actuaries (the "Academy") asking for:

assistance in addressing the issue of fair value for the premiums paid and any other related issues. The working group members are trying to gain an understanding of how, in some instances, cumulative premiums can total several times the amount of insurance provided by small face amount products.

Ms. Barbara Lautzenheiser, Vice President of the Academy, appeared before the Working Group and agreed to assist in the study of small face amount products. She opined that the matter before the Working Group was not an actuarial problem. Rather, she said that small face amount policies have a higher unit price than large face amount policies. She went on to state that while the Academy was willing to help the Working Group, she was not optimistic that the answers sought by the Working Group would be found in any actuarial analysis.

Commissioner Nichols expressed

his appreciation to the Academy and outlined an agenda for consideration by the Working Group. In addition, he reaffirmed his goal that the Working Group complete its study by June, 2001. With regard to the future, he stated that he would like the Working Group to address the following issues:

1. The discounting of premiums when the policyowner changes the mode of payment from weekly or monthly debit to bank draft;
2. Whether an insurer should be required to present all of its products to a prospective client at the time of sale (the "Portfolio Issue"); and
3. Whether a policyowner should receive a disclosure advising as to the fact that premiums paid may exceed the face amount of the policy.

Subsequently, on December 8, 2000, representatives of the Consortium held a conference call to discuss issues relating to the Working Group. The Consortium agreed to: (a) assist the Academy in its efforts to provide information to the Working Group, (b) respond to the Working Group on the agenda items above, and (c) prepare follow-up materials requested by the regulators during the October interim meeting.

### V. Other Activities

On February 7, 2001, the Consortium wrote Director Csiszar and Commissioner Pickens for the purpose of reaffirming the commitment of the industry to provide information and assistance to the Working Group in its analysis of the small face amount life insurance business. The Consortium also asked for direction from Director Csiszar and Commissioner

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Pickens on how it should best use its resources. Specifically, it requested whether the industry should focus its immediate attention on assisting the Academy, or whether it should begin the time consuming and expensive process of completing survey questions asked by the regulators in October. (Representatives of the Consortium met with Director Csiszar and Commissioner Pickens to stress the importance of an answer to this question.) The letter dated February 7 also contained information supplementing responses to questions previously asked by the Working Group at the October interim meeting.

After February 7, the Consortium worked to prepare an agenda and materials for presentation to the Working Group at an interim meeting scheduled for February 22, 2001. The Consortium was also involved in discussions with the Academy on the scope of its proposed study. In addition, several actuaries of Consortium members were invited to participate in the Academy committee's activities.

### VI. The February 2001 Interim Meeting

On February 22, 2001, the Working Group held its second interim meeting. The meeting was co-chaired by Director Csiszar and Commissioner Pickens. Director Csiszar outlined the many different issues the Working Group had discussed over the last eight months, and distilled them into the following three questions:

1. Is the small face amount industry making excessive profits on the backs of the poor?

2. Are small amount products properly priced, and are they actuarially sound?

3. What types of disclosures should be offered to purchasers of small face amount products?

Commissioner Pickens opined that the Working Group should develop a meaningful disclosure, and added that the Working Group should set specific objectives and establish timelines for its work.

A representative of a consumer group was present and spoke about the content of any possible disclosure. She also indicated that there are several other consumer groups that would want to be heard before any final result was reached. (The Consortium expects the other groups to be present at future meetings of the NAIC. As consumer groups become more active, the industry will need to respond with an independent analysis of the small policy market in order to contradict the perceptions of the consumer groups and some regulators.)

Following a lengthy discussion, with many contrasting views, including an offer from the Consortium to initiate its own actuarial analysis and economic study of small face amount products (and report to the NAIC), the Working Group agreed to focus its effort on a disclosure statement. Two actuaries, one from the South Carolina Insurance Department and one from the Arkansas Insurance Department, agreed to examine the disclosure issue in more detail and to report back to the Working Group. As a part of their review, the actuaries agreed to address the following questions:

1. Is the sum of the premiums paid on small face amount policies greater than death benefits?

2. Will premiums paid exceed death benefits within 10 years from the date of policy issue?

3. Whether a disclosure statement should include a "free-look" period for the policy, i.e., all policyowners are entitled to a full refund of premiums paid within 30 days of the receipt of the policy and disclosure.

4. Whether a disclosure statement should contain a list of options available to a policyowner when the premium paid equals or exceeds the face amount.

Director Csiszar stated that the Working Group would review its progress on a disclosure statement at the Spring Meeting of the NAIC scheduled for March, 2001. He mentioned the likelihood of an interim meeting of the Working Group in late Spring, and reminded the Working Group that its final report is due in June, 2001.

Due to the stated interest of the Working Group, the Consortium determined to assist the Academy in an actuarial study and commission an economic study to answer the following questions: (1) whether premiums charged for small face amount products are reasonable in relationship to other products in the market which insure similar risks; and (2) whether the profits of the companies issuing small face amount products are reasonable when compared to the rest of the life insurance market?

Other issues that will undoubtedly arise during future discussions are: (1) at what point in the sale process will the disclosure be required; (2) where will the disclosure be located; and (3) will there be an event (such as a premium-to-benefit ratio) that triggers a more severe disclosure?

## VII. The March 2001 Meeting

On March 27, 2001, the Working Group held its third regular meeting. The participants focused their attention on the two industry studies and the development of the disclosure statement. The industry informed the Working Group that the Academy has agreed to prepare a report to educate regulators about the pricing of small face amount products. Mike Pressley, the Chairman of the Academy's Small Policy Task Force, gave a detailed presentation on this matter. On a related topic, the industry described its efforts to retain the services of Professor Michael Porter, of the Harvard Business School, to review the profitability of companies that write small face amount products. While the scope of this project remains to be defined, the issue is of interest to several regulators who are concerned that some companies are making "excessive profits on the back of the poor."

On a going forward basis, the Working Group agreed to give its immediate attention to the preparation of a disclosure statement. It will then turn its attention to the industry studies, which will be completed this year. The Working Group left open the possibility that it may subsequently address problems that are raised in the industry studies, if any.

## VIII. The May 2001 Interim Meeting

On May 2, 2001, the Working Group held its third interim meeting. Discussion focused on the disclosure statement, multiple policies, the actuarial study to be performed by the Academy, and the public policy issue of providing enhanced benefits to insureds whose policy premiums exceed the death benefit over a certain amount.

With regard to the disclosure

issue, it was determined that a special subcommittee of the Working Group would hold a telephone conference call within the next two weeks to develop the final draft of a proposed disclosure statement for consideration by the Working Group.

The subcommittee was instructed to begin its work by using the generic disclosure statement submitted by the industry. The Working Group agreed that no disclosure will be required if premiums will never exceed the face amount of the policy (for example, single premium products) and that an exemption will be given to policies where age, sex, or other demographics would make it impossible for premiums to exceed the death benefit during the term of the policy. If it will not be possible for a company to calculate whether premiums will exceed the death benefit for a particular policy, the Working Group agreed that a company can provide the disclosure statement to all policyholders. The Consortium provided the Working Group with feedback on a number of related issues in a letter dated April 20, 2001, and a follow-up memorandum dated April 24, 2001. The Consortium was successful in its efforts to avoid a date specific disclosure and to keep the disclosure statement as generic as possible. In addition, the Consortium achieved its goal of ensuring that the disclosure statement would be provided to consumers no later than the date of policy delivery.

The multiple policy issue was discussed at the request of Illinois Director of Insurance Nap Shapo, who asked that companies exercise due diligence in locating all policies when a claim is filed for a named insured. Apparently, this matter surfaced in Illinois during a market conduct examination. Members of

the Working Group and representatives of the industry agreed that reasonable due diligence is appropriate, and indicated some agreement can be reached as long as a specific process for searching for a named insured is not mandated by the NAIC.

Mike Pressley, a representative of the Academy, discussed the status of the pending actuarial study. The Working Group expressed its concern that the data utilized by the Academy may not be sufficiently independent to satisfy regulators and other third parties who will review the final product. The Working Group agreed to appoint a subcommittee to develop a set of questions from regulators that should be addressed in an actuarial study. In addition, the subcommittee will recommend a method for collecting data and a process for conducting the study. The efforts of the Academy were put on hold pending the submission of this information.

The issue of whether enhanced benefits should be provided to policyholders whose premiums exceed the death benefit was discussed by the Working Group. While no consensus was reached, it is clear that several members of the Working Group wanted to talk about the matter in the context of legislation recently considered in the state of Florida. That proposal includes an annual notice to all policyholders with death benefits of \$15,000 or less and benefit enhancements to all policies where cumulative premiums exceed 250% of death benefit. The industry anticipated a full discussion of the Florida bill by a representative of the Florida Department of Insurance at the June meeting of the Working Group.

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### IX. June NAIC Meeting

The Consortium continued to assist the Working Group in developing a disclosure statement. The Working Group voted to expose a draft disclosure statement during the June meeting of the NAIC. That happened with little incident, primarily due to the closeness with which the Working Group worked with consumer representatives. Public comments to the draft disclosure will be addressed at the September NAIC meeting. We expect adoption of the final measure will take place in September.

The study sub-group will receive comments and information to

assess: 1) the magnitude of the "problem" with premiums exceeding face amount; 2) if the problem exists, find out how and why it happens; 3) the role for regulatory intervention. It will assess the effect of a regulatory "solution" to the problem. It will study what information needs to be collected, who will collect it, and will use services of AAA if at all possible, with consumer group input. Industry is quite concerned with confidentiality due to the continued threat of legal action.

There was a brief report on the proposed Florida legislation. Similar action was considered, but not passed.

### X. Future Developments

With regard to the actuarial study, the Consortium will stay in contact with the Academy and will cooper-

ate with the Working Group in developing an appropriate report. The economic study, which was of significant interest to the Working Group several months ago, has been temporarily set aside in order to focus on the disclosure statement and the actuarial study. Because regulators may want to increase the scope and costs of the economic study, the Consortium has informed the Working Group that it reserves the right to discuss the matter in detail before agreeing to underwrite the project.

*Rick Campbell is the Managing Partner of the law firm of Mitchell, Williams, Selig, Gates & Woodyard, P. L. L. C. in Little Rock, Arkansas. He may be reached by telephone at 501-688-8882 or by e-mail at RCampbell@mwsqw.com.*

## Your ideas for NTM programs for 2002

We recently sent the following blast e-mail to NTM Section members, but in case you aren't on e-mail, passed it by for one reason or another, or have since come upon an idea or two, we are repeating the request here because we really do want your input.

Planning has begun for programs the Nontraditional Marketing Section might sponsor in 2002.

We welcome your ideas for sessions or speakers for the Spring or Annual Meeting programs, or for seminars, in 2002. Don't hesitate to suggest your own desire and qualifications for participation, though this is clearly not necessary.

For the Spring meetings we are considering a group of sessions related to Internet marketing, e.g., 101; Regulation; Strategies; Integration with Brick and Mortar; Long term perspectives; and Actuaries and the Net. Individual sessions on Credit, Worksite, Direct, and Bancassurance marketing are also possibilities. Any thoughts on such sessions and/or speakers for them would be most appreciated.

Annual meeting topics are wide open.

Please direct your suggestions to Steve Cooperstein, who is handling the Spring Meetings, at SC@IS4Life.com or 831 655-8670, or Tom Bakos, who is handling the Annual meeting, at tbakos@blazenet.net or 717/671-6672.