

NAIC Spring 2005 Meeting – Salt Lake City

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Beautiful weather and an elegant setting at the Grand America Hotel graced the NAIC conference and offset the buzz of negotiations, deliberations, and confrontations. The session on title insurance and alleged kickbacks related to the Spitzer probe attracted the largest audience. Life and health insurance topics focused on speed to market, actuarial guidelines for lifetime guarantees, consumer advocate concerns, small policies, and agent licensing for term insurance. The meetings reflected the process of dialogue, cooperation, political pressure, and turf battles.

I made and renewed many contacts with insurance companies, regulators, and consumer advocates. Many of these people were involved with the life insurance illustration model, annuity suitability model, and other disclosure and insurance support issues.

Lifetime Guarantees – Actuarial Guideline 38 (AG 38)

Our April 12th Market Connection call will feature Scott Harrison, lawyer and spokesman for the Affordable Life Insurance Alliance (ALIA), and Wayne Stuenkel, Chief Actuary of Protective Life, one of the founding companies of the alliance. At the NAIC meetings, Harrison and Stuenkel provided several comments as interested parties at the actuarial task force meetings (LHATF). The meetings reflected the controversy and political pressures on actuarial guidelines and reserve requirements for lifetime guarantees, the long-debated reformation of reserve rules, and the NAIC process.

In December, the Life A Committee charged LHATF with developing a principle-based approach for the March meeting. Many on the committee saw the charge as posing conflicts and leaving them with an uncertain and impractical task. Others felt they could proceed with the charge. In particular a conflict existed between the chair from New Mexico and the Arkansas representative. Many regulators seemed to view the alliance companies as violating the spirit of the XXX regulations with their interpretation of AG38. At the meetings, no one seemed to raise solvency concerns or question the view that XXX imposes additional costs through redundant reserves, particularly for preferred classes. These past discussions may reemerge, but the current focus was on the regulatory process and the competitive fairness in interpreting laws and guidelines.

The March issue of Best Review highlights this controversy. In 2004, a proposal to change or clarify AG 38 was offered by New York State Insurance Department actuary, William Carmello. The article says, "His proposal is backed by, among others, Northwestern Mutual, New York Life, and American International Group Inc. ... Carmello's main concern is solvency. ... He is also concerned with having 'a level playing field'." ALIA opposes Carmello's proposal and contends that it would impose unnecessary costs. We will see if the solvency debate is renewed. Consumers and agents need be confident that companies can support these lifetime guarantees. Otherwise the focus seems to be on whether we have a level playing field.

The article also cites Mark Konen of Jefferson Pilot (part of ALIA) and Bill Koenig of Northwestern Mutual. Koenig and his supporters also voiced their concerns at the NAIC meetings. The article refers to his concerns of fairness, saying similar guarantees should carry similar reserves. The mutual companies and others do not want a lapse assumption under AG 38. ALIA and other parties maintain that the lifetime guarantee products are carefully tested and the risks are reasonable.

The conclusion of the meetings on this topic is substantial pressure to move away from a formulaic approach for reserves and toward a principle-based approach. An asset adequacy approach would be a step in this direction.

As long as tax laws provide a tax-free death benefit, the market will seek ways to provide this tax advantage with a low premium. Lower tax rates on lifetime income or other changes could shift the market more toward accumulation products. The lifetime guarantee products tend to limit accumulation as a trade-off for the low premium.

The NAIC illustration model is the standard and it prohibits showing values greater than the disciplined current scale. The lifetime guarantee products are mainly a competitive response to market demand for guarantees, but they also reflect the fact that products cannot show the potential for values greater than current.

Perhaps a disclosure change could help address the level playing field issue. Illustrations could show how the guarantees and upside potential differs between lifetime guarantee products with non-traditional reserves and more traditional products. If the lifetime guarantee product does not illustrate non-guaranteed values, then a traditional product could highlight higher guaranteed values and also the potential for larger non-guaranteed values. Or if the lifetime guarantee product shows non-guaranteed values in its illustration, a disclosure could be added about the trade-off for providing the lifetime guarantees. A decline in interest rates would not increase the required premium to guarantee the death benefit. The trade-off is that the policy is less likely to increase its interest rate or provide other factors to increase cash values compared to a policy design that does not have the lifetime guarantee.

Scott Cipinko's Market Connection Call

Our Market Connection call on March 17th featured Scott Cipinko, Executive Director of LOMA's Life Insurance council (LIC). Scott gave an overview of the NAIC meetings including a perspective on the AG 38 debate. If you would like to hear a recording of the session, please contact me at chrisk@cosssdev.com. To get LIC's periodic reports and bulletins, contact Scott at cipinkos@loma.org or (770) 984-3785.

The following notes blend my notes from the meetings and my notes from Scott's presentation. Due to time limits and my potential misunderstanding, do not rely on these notes as a final word. We will post future corrections or updates as needed. Your feedback is appreciated.

Sarbanes-Oxley

Scott noted the high turnover of commissioners and staff and how new and old issues can emerge and reemerge. A few people can drive an issue. As an example, two staff members mainly drive discussions regarding Sarbanes-Oxley. Insurance companies are concerned about costs and the potential extension to smaller and private companies. Are the safeguards of a regulation worth the costs? Metropolitan Life estimates a multi-million dollar rolling annual expense for Sarbanes-Oxley compliance, comparable to the cost of rolling out a new line of business each year.

Broker Activity & Consumer Advocacy

Discussions of broker activities could lead to proposals for commission disclosure. Similar disclosure in the United Kingdom was questionable in value and dramatically decreased insurance sales. Birny Birnbaum, a consumer advocate and former economist of the Texas DOI, advocates this type of disclosure for all insurance products. He also wants agents to present a minimum of three choices to a consumer. Scott Cipinko noted how these potential requirements could conflict with existing regulations.

Birny Birnbaum was a key presenter at a session on consumer advocacy concerns. He introduced Evan Mills, PhD of UC Berkeley and formerly of the US DOE. Dr. Mills gave a presentation on climate change and concerns for life, health, and P & C insurance. See <http://eetd.lbl.gov/insurance>. Other advocates addressed concerns of available, affordable, and sufficient insurance for various groups of people.

Small Policies

A disclosure for small policies was approved. It refers to the point where the total premiums paid may exceed the face amount. Scott Cipinko noted cases of old policies or policies with riders that pose difficulties in fairly or accurately doing this calculation. Watch for whether regulators extend similar concerns to larger policies.

Insurable Interest

The NAIC plans to look into insurable interest concerns prompted by activities of investors in life insurance policies where a small percentage of the benefit goes to a charity. These discussions could extend to Lifetime Settlements. Also, any investment orientation of life insurance raises concerns of losing tax advantages for inside build-up of cash value.

Agent Licensing for Only Term Insurance

Peter Schneider, Executive VP & General Counsel of Primerica, gave an impassioned, but rejected plea to the Producer Licensing Working Group to recommend that agents have a shorter training requirement to only sell term insurance. Alabama, Mississippi and Illinois are considering adoption of a similar law. Mr. Schneider noted by comparison that the investment world has different levels of licensing for agents who only sell mutual funds (Series 6) versus

those who can also sell stocks (Series 7). He said that Primerica focuses on underserved lower income markets. Simplifying requirements would help them expand their service to this market. He noted that the victims of September 11th included many Primerica policyholders. They were not the executives and other high-income professionals in the Twin Towers, but they were firemen, policeman, and blue-collar workers there.

Regulators questioned whether the proposal for the simpler licensing might lead to another surge of replacement activity that regulators have combated in the past. Peter said that Primerica has dramatically decreased replacements and that last year they only received two complaints filed with states. A regulator said that some agents encourage people to wait a while to drop existing policies in order to avoid doing replacement forms.

After the session, I talked with Peter. If this simpler licensing gains traction in another place or time, he would likely accept an extensive prohibition on replacement for these agents. Since these agents would not be trained in life products other than term, discussion of replacing existing insurance would not be fair or appropriate. You would still have the problems of what to do if consumers bring up the idea on their own and how do you know if the agent is suggesting or implying replacement.

Orphan Policies and Administration Systems

Regulators and consumer advocates would like for people to be able to check on whether a company has a life insurance policy on a deceased relative. Linda Lanam of the ACLI noted that as a practical matter the request needs to be based on some evidence of a policy existing. Most companies have multiple administration systems and databases. Some older policies are not on any computer system. Doing a search through all of these systems and records would be costly. Evidence of a policy would suggest what system or records to check and makes the discovery of an in-force policy more likely. An analyst noted that companies who have gone through demutualization have aggregated databases of all policyholders and should be able to efficiently do a broad search.

Speed to Market

The committee reported on a doubling of SERFF activity (electronic filing of rates and policy forms). Related to ACORD's efforts, I thought the NAIC was far along and involved with setting standards for policy applications. However, the focus seems to be on product filings by companies and not policy applications. I need to study the issue more to see where potential overlap exists. The committee set a work schedule for the rest of 2005 to try to set standards for riders, HIV statements and other state policy variations.

NAIC Portal

I attended demonstrations of the NAIC Portal. The press release is listed below. They would like to add content to help explain insurance concepts to consumers.

NAIC UNVEILS NATIONAL PORTAL SEARCH ENGINE

SALT LAKE CITY, UT (March 15, 2005) - A single point of entry for access to insurance information, services and tools for consumers, regulators and industry will be available on March 16 through the National Portal for Insurance Regulatory Information on the National Association of Insurance Commissioners' (NAIC) Web site at www.naic.org. At this stage, the Portal is a search engine that allows users to retrieve publicly available information from the NAIC and individual state insurance department Web sites. Content from state insurance department Web sites is targeted to increase relevance, to assure authenticity and update regularly to be timely. In order to maintain the accuracy of the search engine, the Portal is scheduled to check for updates on state insurance department Web sites at weekly intervals.