

PROJECT HISTORY - 2004

DETERMINING RESERVE LIABILITIES FOR CREDIT LIFE INSURANCE MODEL REGULATION (#818)

1. Description of the project, Issues Addressed, etc.

The “Purpose” section of the model describes its objective:

Section 3. Purpose

The purpose of this rule is to:

- A. Recognize the 2001 CSO Male Composite Ultimate Mortality Table for use in determining the minimum standard of valuation.
- B. Specify the interest rate and method to be used in determining the minimum standard of valuation.

This model evolved from the work of the Credit Insurance Experience Committee of the Society of Actuaries. This excerpt from that committee’s June 2002 report gives its recommendation:

In May of 2001 the Credit Insurance Experience Committee was asked to respond to the National Association of Insurance Commissioner’s request to the Society of Actuaries to develop a recommendation for a uniform national valuation standard for credit life insurance policy reserves.

The enclosed report contains the recommendation along with supporting material.

The Committee recommends that the 200X (i.e., 2001) CSO Male Composite Ultimate Table be used for the valuation of credit life policy reserves using the dynamic interest rate appropriate for the original term of insurance. For joint life coverage the Committee recommends that the reserve be set assuming 200X (i.e., 2001) CSO Male Composite Ultimate Table using twice the mortality for the age of the primary insured. Credit insurers do not normally maintain gender specific records, so certificates of both genders should be reserved on the male table.

The recommended standard is set at a level such that 23 of the 27 companies contributing data to the study, or 85%, showed aggregate mortality less than or equal to the standard. Overall, this standard provides a 27% margin over the experience from 1998 and 1999.

2. Name of Group Responsible for Drafting the Model and States Participating

The Life and Health Actuarial Task Force developed this model. The 2004 members are: South Carolina (Chair), Alaska (Vice-Chair), Arkansas, California, Connecticut, Florida, Kansas, Minnesota, Nebraska, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Texas, and Utah.

3. Project Authorized by What Charge and Date First Given to the Group

The 2004 charge given to the Task Force was: “Discuss the feasibility of developing a valuation mortality table for credit life insurance. Consult with the Society of Actuaries, the American Academy of Actuaries, and other interested parties on this matter. Complete work on this matter by the Winter National Meeting.” This charge represents a continuation of previous charges given to the Task Force.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

This model evolved from the work of the Credit Insurance Experience Committee of the Society of Actuaries. That committee presented its recommendations to the Task Force in a June 2002 report. Subsequently, the full Task Force worked with a representative of that committee and other interested parties in the development of the model.

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The efforts of the Task Force were closely coordinated with all industry interested parties. In addition to open sessions at the quarterly meetings of the NAIC, numerous conference calls were held to discuss this matter. Notice of those conference calls was posted on the NAIC's home page on the Internet and e-mailed to approximately 200 interested parties, including representatives of the American Council of Life Insurers and the Consumer Credit Insurance Association.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group's response)

Given the complexity of this project, it is impossible for a brief summary to address all the issues that were raised. However, two main issues that were addressed are:

- The extent to which use of unearned premium reserves is consistent with the Commissioners Reserve Valuation Method (CRVM) as prescribed by the Standard Valuation Law.
- The appropriate application of CRVM to such plans as "level monthly" plans.

Relative to the first point, the task force agreed to include this Drafting Note in the model:

The Standard Valuation Law contains language permitting the use of "group methods and approximate averages for fractions of a year or otherwise." Such methods may be appropriate in those situations where individual certificate data is not readily available to the insurer. This is especially common in monthly payment programs, with frequent remittance of small premiums.

The intent of the Drafting Note is to point out that, under the circumstances described, there may be multiple acceptable techniques for achieving compliance with CRVM. On the July 24, 2003, conference call of the Task Force, Michael Batte (NM) (chair of the Task Force at that time) made the following statement, which explicitly referenced unearned premiums:

Mr. Batte stated, "my own personal opinion is the reason we use unearned premiums for these kinds of group life insurance contracts is because that exceeds what would be required on a mortality basis for the risk guaranteed." Mr. Batte summarized his comments by saying, for many of the types of group contracts under discussion, the unearned premium reserve "is a CRVM compliant reserve."

The decision was made to address this point through a Drafting Note rather than the formal text of the model. This excerpt from the Nov. 18, 2003, conference call of the Task Force documents the decision not to reference any reserve methodology other than CRVM (i.e., Section 5 of the SVL) within the formal text:

Ms. Philips asked Mr. Carmello if Mr. Hause's suggestions addressed his concerns. Mr. Carmello stated that he was unclear as to the exact nature of Mr. Hause's proposal. Ms. Philips responded that Mr. Hause's proposal is to "strike the portion that talks about a different reserve method for outstanding balance or MOB (monthly outstanding balance) or anything, and just say that the minimum reserve standard shall be the Commissioners Reserve Valuation Method." Mr. Carmello said, "so that would require a mortality reserve, even for MOB?" Mr. Hause responded "yes." Mr. Carmello stated this would also "address the level premium issue, because under CRVM they would have to go through the motions there, even if it doesn't produce anything."

Relative to the second point pertaining to "monthly level" plans, the concerns of the industry were expressed in these excerpts from an August 20, 2003, letter from William F. Burfeind, Executive Vice President, Consumer Credit Insurance Association:

Group term life insurance is renewable by group and rates are subject to change, generally once a year. For many group life insurance cases the amount of insurance is a fixed level amount and not tied to the employees' current salary. The rate charged is usually one rate for all ages and while the rate may be changed annually it is the practice of insurers to avoid rate changes. These same group term life risk characteristics are also applicable to most level monthly credit life products.

Many of the monthly level credit life products have one rate for all ages. This is consistent with the prima facie rates in the states. While states allow actuarial equivalent rates our experience has been that some states will not approve age rated credit life products.

The model valuation law requires in any contract year where the gross premium charged is less than the valuation net premium, the valuation premium is replaced by the gross premium in determining the present value of future premiums. This “premium deficiency reserve” will be onerous at high issue ages in the level monthly credit life products that have one all age rate. If CRVM reserves are required will this premium deficiency reserve requirement follow, even when rates are not guaranteed?

In response, the Task Force agreed to the inclusion of the following Drafting Note:

In applying the commissioners reserve valuation method, consideration should be given to the period of time for which renewability of benefits are guaranteed under the contract. If benefits are guaranteed for less than one year, the method produces a reserve equal to the mortality cost from the valuation date to the premium “paid-to” date.

7. Any Other Important Information (e.g., amending an accreditation standard)

This is a new model regulation. The NAIC has never before promulgated reserve standards that explicitly address credit life insurance.

The scope of Statement of Statutory Accounting Principles No. 59 is:

This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as credit life and credit accident and health contracts defined in *SSAP No. 50 – Classifications and Definitions of Insurance or Managed Care Contracts In Force*.

Given that the model directly relates to the issues addressed by SSAP No. 59, the Statutory Accounting Principles (E) Working Group may wish to consider the extent to which the model should be incorporated into the *Accounting Practices and Procedures Manual*.