

KEN HECHLER
Secretary of State

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STATE OF WEST VIRGINIA
SECRETARY OF STATE
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1900 Kanawha Blvd., East
Charleston, WV 25305-0770

WILLIAM H. HARRINGTON
Chief of Staff

CATHERINE FREROTTE
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JUDY COOPER
Director, Administrative Law

PENNEY BARKER
Supervisor, Corporations

(Plus all the volunteer
help we can get)

September 9, 1998

NOTICE OF EMERGENCY RULE DECISION BY THE SECRETARY OF STATE

AGENCY: INSURANCE COMMISSION

RULE: AMENDMENTS, SERIES 49, VALUATION OF LIFE INSURANCE POLICIES

DATE FILED AS AN EMERGENCY RULE: JULY 30, 1998

DECISION NO. 10-98

Following review under WV Code 29A-3-15a, it is the decision of the Secretary of State that the above emergency rule is **approved**. A copy of the complete decision with required findings is available from this office.

A handwritten signature in cursive script that reads "Ken Hechler".

KEN HECHLER
Secretary of State

OFFICE OF THE SECRETARY OF STATE

SEP 10 10 30 AM '98

FILED

KEN HECHLER
Secretary of State

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EMERGENCY RULE DECISION
(ERD 10-98)

AGENCY: INSURANCE COMMISSION
RULE: AMENDMENTS, SERIES 49, VALUATION OF LIFE INSURANCE
POLICIES

FILED AS AN EMERGENCY RULE: JULY 30, 1998

- par. 1 The Insurance Commission (Commissioner) has filed the above amendments to an existing rule as an emergency rule.
- par. 2 West Virginia Code 29A-3-15a requires the Secretary of State to review all emergency rules filed after March 8, 1986. This review requires the Secretary of State to determine if the agency filing such emergency rule: 1) has complied with the procedures for adopting an emergency rule; 2) exceeded the scope of its statutory authority in promulgating the emergency rule; or 3) can show that an emergency exists justifying the promulgation of an emergency rule.
- par. 3 Following review, the Secretary of State shall issue a decision as to whether or not such an emergency rule should be disapproved [29A-3-15a].
- par. 4 (A) Procedural Compliance: WV Code 29A-3-15 permits an agency to adopt, amend or repeal, without hearing, any legislative rule by filing such rule, along with a statement of the circumstances constituting the emergency, with the Secretary of State and forthwith with the Legislative Rule-Making Review Committee (LRMRC).
- par. 5 If an agency has accomplished the above two required filings with the appropriate supporting documents by the time the emergency rule decision is issued or the expiration of the forty-two day review period, whichever is sooner, the Secretary of State shall rule in favor of procedural compliance.
- par. 6 The Commissioner filed this emergency rule with supporting documents with the Secretary of State July 30, 1998 and with the LRMRC July 30, 1998.

par. 7 It is the determination of the Secretary of State that the Commissioner has complied with the procedural requirements of WV Code §29A-3-15 for adoption of an emergency rule.

par. 8 (B) Statutory Authority -- WV Code 33-2-10 reads:

The commissioner is authorized to promulgate and adopt such rules and regulations relating to insurance as are necessary to discharge his duties and exercise his powers and to effectuate the provisions of this chapter and to protect and safeguard the interests of policyholders and the public of this State.

par. 9 It is the determination of the Secretary of State that the Commissioner has not exceeded its statutory authority in promulgating this emergency rule.

par. 10 (C) Emergency -- WV Code 29A-3-15(f) defines "emergency" as follows:

(f) For the purposes of this section, an emergency exists when the promulgation of a rule is necessary for the immediate preservation of the public peace, health, safety or welfare or is necessary to comply with a time limitation established by this code or by a federal statute or regulation or to prevent substantial harm to the public interest.

par. 11 There are essentially three classes of emergency broadly presented with the above provision: 1) immediate preservation; 2) time limitation; and 3) substantial harm. An agency need only document to the satisfaction of the Secretary of State that there exists a nexus between the proposal and the circumstances creating at least one of the above three emergency categories.

par. 12 The facts and circumstances as presented by the Commissioner are as follows:

The legislative rule designated Title 114, Series 49 sets forth a method for calculating reserves for certain term life insurance policies (specifically those guaranteeing premiums for more than 5 years). The rule is based upon an NAIC (National Association of Insurance Commissioners) model regulation labeled the "Triple-X" regulation. Consequently, the legislative rule here will be referred to simply as "Triple X."

Triple X requires higher reserves for policies it covers. Once implemented, the rule would have the following effects.

- In preparing annual statements and any other descriptions of their financial condition, life insurers selling such policies would have to use the new method to calculate their reserve liabilities. See WV Code §§33-4-14 (requiring the filing of a "true statement of financial condition") and 33-7-5(c)(1) (requiring that "in any determination of the financial condition of the insurer," reserves calculated according to WV law be treated as liabilities). This would be true both of domestic life insurers (i.e. those incorporated in the state of West

Virginia) and foreign life insurers (i.e. those domiciled in some other state but issuing policies on the lives of WV residents).

- To obtain an unqualified actuarial opinion, life insurers (again, both domestic and foreign) would have to maintain reserves at the higher levels required by Triple-X. WV Code 133-7-9(c)(2)(A); 114CSR 41; §§114-41-6.2.f.C and 114-41-7.2.f.C. In general, an actuarial opinion must accompany each life insurer's annual statement of financial condition, and must be supplied at such other time as the Commissioner finds it necessary to assess an insurer's financial condition. WV Code §33-7-9(c)(1); 114CSR41 §114-41-1.1. Although an insurer maintaining lesser reserves could obtain a qualified opinion (see 114CSR41 §§114-41-6.2.i and 7.4), the insurer nonetheless would have to increase its reserves afterwards to the higher level. 114CSR41 §114-41-4.5.b.
- When assessing the financial condition of a life insurer, the Insurance Commissioner would recognize a reserve liability at the higher level required by Triple-X. See WV Code §33-7-5(c)(1). If the insurer has not established reserves at that level, the Commissioner consequently might find that the insurer is impaired or insolvent.
- Upon increasing its reserves to the higher levels required by Series 49, a life insurer almost certainly will increase its premiums covered by that rule. Reserves, after all, represent funds that are not available to the insurance company for general use, so that an increase in reserves is tantamount to a reduction of profits.

Triple X does not apply only to those policies covering West Virginia residents. Instead, the rule applies to all policies of the type indicated (i.e. term life insurance with a premium guaranteed for more than 5 years). Instead, the rule applies to all policies of that type written after the effective date of the rule, regardless of the state of residence of the person whose life is insured under the policy.

For reasons described in detail under "Statement of Circumstances," implementing Triple X in West Virginia before comparable rules have been implemented in other states threatens to destabilize the market for term life insurance policies (and specifically for those policies covered by Triple X) in this state. This emergency rule, therefore, repeals Triple X in its entirety. Once the rule is repealed, reserves for all term life insurance policies will be calculated using the method described in WV Code §33-7-9. That method was used to calculate such reserves prior to the promulgation of Triple X. Should a significant number of states implement versions of Triple X in the future, an appropriate rule will be promulgated.

As described in the above summary, implementing Triple X will place a significant burden on many insurers that offer term life insurance. These insurers will be forced to follow a different method to calculate reserves for term life insurance policies (and, because such calculations are done by computer, to develop or purchase new software capable of using that new method); to state these new reserves on all statements of financial condition filed with the Commissioner; and to maintain reserves for the policies at the higher rate called for by the newer method. Because this increase in reserves reduces the amount of funds available

to the insurer, most if not all insurers will want to raise the premiums for those policies to which the new method applies. To do so, an insurer would have to prepare an application for the new rates and file that application with the Commissioner.

Were this new method required by most other states, insurers would be compelled to make these changes in order to remain in business. If West Virginia requires this method before other states, however, insurers subject to that requirement -- especially smaller insurers -- well may conclude that it is preferable to cease operations in West Virginia in order to avoid the burdens described above. (See attached letters from term life insurers and trade groups representing such insurers.) The Commissioner has the duty of promoting an adequate market for insurance in this state. Ideally, there should be a number of insurers selling each type of insurance. More insurers means increased competition among insurers, a greater range of choices for consumers, and reduce reliance on any one insurer. It is important to note that, once Triple X goes into effect, an insurer may not avoid those requirements simply by refusing to write new policies in West Virginia. Instead, the insurer would have to surrender its West Virginia license. Triple X requires that the new reserving method be used for all policies, regardless of their situs, that are written when the rule is in effect. Even an insurer that writes no policies on West Virginia residents must calculate, report and maintain reserves at the higher Triple X level on new policies covering other states' residents. This last requirement is especially serious. To obtain unencumbered funds despite the higher reserves, an insurer would have to raise its premiums on all new policies. By doing so, the insurer well may cease to be competitive with insurers that offer equivalent policies but are not subject to West Virginia's requirements.

The danger of implementing Triple X prematurely has been obvious for some time. The rule is based on a model regulation promulgated by the NAIC. The drafters of that model regulation anticipated that some form of the model would be adopted in most, if not all, member states simultaneously. (At present, insurance regulators from all 50 states belong to the NAIC.) At the time that West Virginia's Triple X rule was adopted (early in 1997), it appeared that it would be adopted in a significant number of states by January 1, 1998. Since that time, however, other states have hesitated to adopt Triple X rules with definite effective dates. Instead, those other states have chosen to use the following language to specify an effective date.

The applicability date of this [rule] is January 1 of the calendar year immediately following the adoption of substantially similar requirements by states with an aggregate population of at least 51% of the total population of the USA, according to the most recent General Federal Census.

Because it was first used by the state of Illinois, this language has come to be known as the "Illinois language." While it prevents a Triple X rule from being implemented prematurely, the Illinois language defers implementation for an indefinite period of time -- and by doing so, renders obsolete those rules with definite effective dates.

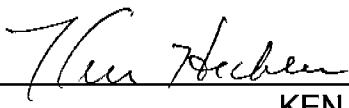
Further, the NAIC - the group that originally developed and espoused Triple X - is

currently considering changes to that model rule. Should those changes be adopted by the NAIC and accepted by a large number of states, Triple X in the form that currently exists in West Virginia may never become widespread.

To avoid implementing Triple X in advance of other states, and by doing so threatening the market for certain term life insurance policies in West Virginia, the emergency repeals Triple X in its entirety. If a significant number of states implement Triple X (either the current version or some new version developed by the NAIC), the Commissioner will promulgate the appropriate version of the rule.

par. 13 It is the determination of the Secretary of State that this proposal qualifies under the definition of an emergency as defined in §29A-3-15(f). . ."prevent substantial harm to the public interest"

par. 14 This decision shall be cited as Emergency Rule Decision 10-98 or ERD 10-98 and may be cited as precedent. This decision is available from the Secretary of State and has been filed with the Insurance Commission, the Attorney General and the Legislative Rule Making Review Commission.



KEN HECHLER
Secretary of State

Entered _____

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OFFICE OF THE SECRETARY OF STATE



TRANSAMERICA
OCCIDENTAL LIFE

November 13, 1997

JAMES M. JACKSON
Vice President and
Deputy General Counsel

Transamerica Occidental
Life Insurance Company
Transamerica Center
1150 South Olive
Los Angeles, CA 90015-2211
(213) 742-5085

The Honorable Hanley C. Clark
Commissioner of Insurance
State of West Virginia
1124 Smith Street
Charleston, West Virginia 23505

RECEIVED

NOV 20 1997

WEST VIRGINIA
INSURANCE COMMISSION

RECEIVED

NOV 20 1997

Re: Valuation of life policies

Copied to
Hc
DW
RP
LTH

Dear Commissioner Clark:

LEGAL DIVISION
W. VA. INS. DEPT.

Transamerica's Life Insurance Companies have been following with great interest the developments regarding the so-called Regulation XXX which was promulgated some time ago by the NAIC. This regulation, as adopted by your state, has an effective date of January 1, 1998. Although we do not oppose implementation of this regulation, we are very concerned that it have a roughly uniform starting date for all states. If it does not, certain companies will be advantaged and certain other companies will be disadvantaged, depending on their market area and concentration.

Although it appears Wisconsin is tentatively adopting a 1-1-99 effective date, many of us are urging them to reconsider and adopt at least a 1-1-2000 effective date, if not a "51%" effective date, which would delay effectiveness until states representing at least 51% of the population in the United States adopt the regulation.

New York has adopted a similar type of regulation, but few companies are licensed to write in New York and all other states.

We strongly urge you to adjust the effective date of your regulation (Title 114, Series 49 of the West Virginia Rules) to match a date consistent with other states, that is, when states representing 51% of the U.S. population adopt the rule. Any effective date earlier than January 1, 2000, will create serious competitive disruptions for no obvious regulatory advantage.

Thank you for considering this request. If we can be of any assistance, please let me know.

Yours truly,

A Transamerica Life Company



NATIONAL ALLIANCE OF LIFE COMPANIES

An Association of Life and Health Insurance Companies

*Copied to
HC
DW
R.P.
TH*

November 11, 1997

Honorable Hanley C. Clark
Insurance Commissioner
State of West Virginia
P.O. Box 50540
Charleston, WV 23505-0540

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NOV 17 1997

**WEST VIRGINIA
INSURANCE COMMISSION**

RECEIVED

NOV 16 1997

LEGAL DIVISION
W. VA. INS. DEPT.

Re: Regulation XXX

Dear Commissioner Clark:

The National Alliance of Life Companies (NALC) has been involved in discussions throughout the United States concerning the implementation of Regulation XXX. Specifically, we have testified in favor of the addition of the Illinois caveat requiring the adoption of the Regulation by states representing 51% of the population of the United States prior to the Regulation becoming effective in any state.

While we believe that the Regulation is not perfect, we strongly urge the uniform adoption of the Regulation. We believe that this is important so that the consumers in West Virginia and consumers that do business with insurers that write insurance coverage in West Virginia not be penalized by the premature adoption of this very important Regulation in one state. Such an impact is being felt by consumers in New York, which adopted Regulation 147, a regulation very similar to Regulation XXX. Consumers have been forced to leave the State to find affordable coverage. The New York Department has recently revealed that it is considering changing the Regulation as a result of the burden placed on its citizens.

The NALC is composed primarily of smaller insurers that compete with much larger insurers, many of which would like to see Regulation XXX adopted in a sporadic manner in order to force all states to adopt the Regulation as soon as possible. However, smaller insurers will be placed in a very difficult position if the larger companies succeed. This would cause insurers to be unable to compete. The resulting loss of choice cannot benefit the consumer.

We understand that an Emergency Rule is contemplated in order to restore the 51% language into XXX. We urge passage of this provision and would be pleased to assist you and your staff in any way.

I am always available to discuss issue of concern with you and your staff. Please contact me if I may be of assistance on this or any other matter.

Thank you for your time and consideration. I look forward to seeing you in Seattle in December.

Sincerely,

Scott J. Cipriano
Executive Director



Wanda S. Smith
Senior Vice President
Insurance Chief Compliance Officer and
Government Relations

3120 Breckinridge Boulevard
Duluth, Georgia 30099
(770) 564-6471 Direct
(800) 356-8974
(770) 564-7948 Fax

November 11, 1997

Hanley C. Clark, Insurance Commissioner
State of West Virginia
1124 Smith Street
Charleston, WV 23505-0540

Dear Commissioner Clark:

This will serve as a follow-up to our letter of July 25, 1997, which is attached. I am writing to reiterate our position regarding the passage of the Valuation of Life Insurance Policies Regulation (Title 114, Series 49 of West Virginia Rules, also known as Triple X), effective January 1, 1998.

As previously discussed, we are concerned with the January 1, 1998 effective date of this regulation. We are hopeful that you will be successful in amending the effective date. Other than New York, to the best of our knowledge, West Virginia is the only state that has adopted this regulation with an effective date as early as January 1, 1998.

Primerica Life does not oppose this regulation. We are, however, concerned that a change of this magnitude, which completely revises long-standing methods of reserving for two of the industry's major product lines -- universal life and term insurance, is being made on a state-by-state basis. The NAIC has worked very hard through the years toward uniform accounting and actuarial reporting for insurance companies. This is evidenced by the Statutory codification project which we strongly support. We believe uniform accounting does assist regulators to better monitor company results, and helps companies in that they do not need to prepare different financial statements for different states.

Uniformity in actuarial reserve calculations are even more important based on the wording of the Actuarial Opinion regulations. (Section 114-41-6, subsection 6.2, paragraph f of the West Virginia regulations.) This part requires that reserves on all policies of a company meet the requirements of the state of domicile and be at least as great as the minimum aggregate amounts required

Primerica Life Insurance Company

Commissioner Hanley C. Clark
November 11, 1997
Page 2

by the state in which the statement is filed. Therefore, all companies licensed in West Virginia with affected products must either comply with your regulation, file a separate annual statement in West Virginia, or withdraw from the state. Consumers in West Virginia could potentially be denied competitive and comparable products than consumers in other states until Triple X is uniformly effective.

To address the issue of uniformity, most of the states which have adopted or are considering the regulation have included a provision that it will not be effective until adopted by states representing at least 51% of the U.S. population. This provision effectively creates uniformity because for all intents and purposes, all companies would be simultaneously impacted. Wisconsin originally adopted the regulation without the 51% rule and with a January 1, 1998 date, but is in the process of revising the rule to mandate a later effective date. New York is not a concern for most companies because they do not write in New York. We strongly support the 51% rule.

Another important consideration, especially for smaller companies, is the timing of the change. This enormous change is right during the time when most of our systems resources are focused on the millennium compliance conversion. Like most financial services firms we are committing most systems resources throughout 1998 to ensure a smooth transition to the new millennium, and the timing for a major change as this is unfortunate.

We are hopeful that you will be successful in amending the regulation to include the 51% rule or provide for a later effective date such as 1/1/2000, and appreciate your attention and understanding of this matter.

Sincerely,



Wanda S. Smith

Attachment

cc: Tim Hrynick
Randall Price
Roy Woodall



Wanda S. Smith
Senior Vice President
Insurance Chief Compliance Officer and
Government Relations

3120 Breckinridge Boulevard
Duluth, Georgia 30199-1000
(770) 381-1000
(770) 279-2752 Fax
(770) 584-6471 Direct

July 25, 1997

Hanley C. Clark, Insurance Commissioner
State of West Virginia
PO Box 50540
Charleston, WV 23505-0540

Dear Commissioner Clark:

Thank you for meeting with Bill Sheppard and me on Tuesday, July 15, 1997, to discuss the impact on Primerica Life if the Valuation of Life Insurance Policies Regulation (Triple X) effective date remains effective 1/1/98 in West Virginia. We greatly appreciated the time you, Randy Price and Tim Hrynick took out of your busy schedules to discuss this issue with us, and thank you for understanding our concerns.

The 1/1/98 effective date of the regulation creates an enormous burden on many insurance companies, particularly smaller ones, which sell term insurance. The reason is that it deviates from uniform accounting and reporting requirements. One of the main missions of the NAIC through the years has been to work toward uniform accounting and actuarial reporting for insurance companies. As you are aware, this is evidenced by such recent activity as the NAIC's codification process. We believe uniform accounting does assist regulators to better monitor company results, and helps companies in that they do not need to prepare different financial statements for different states.

As discussed, the NAIC Model Life Valuation Regulation (Triple X) did not include a uniform effective date. To address the issue of uniformity, most of the 27 states which have adopted or are considering the regulation have included a provision that it will not be effective until adopted by states representing at least 51% of the U.S. population. The advantage of the 51% rule is that, by having the rule effective simultaneously in all states in which a company does business, it is not necessary to file a separate financial statement in those states which have an earlier effective date. Other than West Virginia, only New York and Wisconsin have adopted or are seriously considering the regulation without the 51% rule. However, we believe Wisconsin is considering the regulation with an effective date for as late as January 1, 2000, and New York is not of concern to most companies since they do not do business there.

Hanley C. Clark
July 25, 1997
Page 2

We are hopeful that you will be successful in amending the regulation to add a provision that the regulation will not be effective until adopted by states representing at least 51% of the U.S. population. We stand ready to assist you in any way, and again appreciate your attention to and understanding of this matter.

Please call me toll free at (800) 356-8974 if you would like to discuss this issue further, or if you have any additional questions about our company.

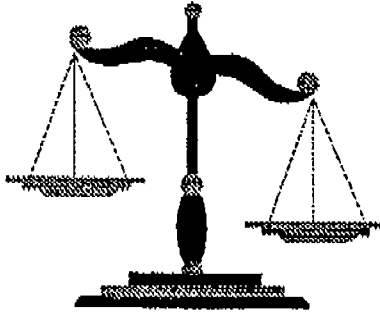
Sincerely,



Wanda S. Smith

cc: Tim Hrynich, WV Department of Insurance
Randall Price, WV Department of Insurance
Bill Sheppard

PRIMERICA LIFE INSURANCE COMPANY
COMPLIANCE ADMINISTRATION - OFFICE OF THE GENERAL COUNSEL



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NOV 12 1997

LEGAL DIVISION
W. VA. INS. DEPT.

PHONE: (770) 564-6471

FAX: (770) 564-7948

PRIVILEGED AND CONFIDENTIAL

TO: Tim Hrynick

FROM: Wanda S. Smith

RE: Triple X

DATE: 11/12/97 11:09 AM

FAX#: (304) 558-1361

TOTAL NUMBER PAGES: (Includes header) 5

Comments: FYI - the attached is being overnighted to the Commissioner today. Wanda Smith

COMPULIFE[®] Software, Inc.

4248 Ridge Lea Road
Amherst, NY 14226
Tel. (800) 567-8376
Fax (519) 745-8581

July 17, 1997

Mr. Hanley C. Clark
Commissioner of Insurance
Dept. of Insurance, West Virginia
P.O. Box 50540
Charleston, West Virginia 25305 0540

*Copied to
HC
DW
Randy
Tom*

Dear Mr. Clark,

It has been several months since I last wrote to you warning you about the Triple-X regulation. It was my hope that the regulation was being recognized as the anti-consumer mistake that it is. However, there is evidence that some states are moving forward with it. Therefore, I am sharing additional material which will prove what a huge mistake Triple-X really is.

1. Enclosed is a copy of a letter from the Insurance Commissioner's office of Wisconsin to a life company that was filing a new 30 year term policy. L.L. Schlinkert, Insurance Examiner, proves that the Insurance Commission of Wisconsin does not have a clue what is contained in the Triple-X regulation. Contrary to the statements made in the letter, the regulation does not prevent companies from offering this type of product. The letter proves either:

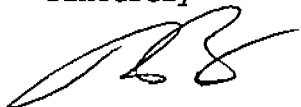
- a) Wisconsin's Insurance Commission doesn't know what it is doing
- b) Wisconsin has accepted the NAIC's fairy tale about this regulation
- c) Wisconsin wants consumers to purchase defective term policies
- d) Wisconsin's Insurance Commission is in the pocket of big life companies

2. Enclosed is a copy of an article I wrote for the May 1997 "small talk" newsletter. The newsletter is published by the Smaller Insurance Company Section Council of the Society of Actuaries. If the Society of Actuaries believes that I have something important to say on this subject, shouldn't you pay attention? Please read my article.

3. Enclosed is a copy of the front cover of a rate card for a new term product which has Triple-X "5 year" guarantees. While some states pass illustration regulations purporting to protect consumers from false promises, life companies continue to tell consumers that they can be trusted not to raise prices for non-guaranteed policies. Have we learned nothing from the vanishing premium debacle? Why would any state pass a regulation that makes non-guaranteed term policies the new standard in the market?

As per my article, I am happy to provide you with a copy of the transcript of the Larry Gorski/Mark Oberhellman, October 1996 debate on Triple-X. You need to see that Mr. Gorski, this regulation's leading advocate, cannot adequately address or respond to the problems that this regulation will create.

Sincerely



Robert L. Barney
President

cc. The Governor of your state, Compulife subscribers



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Tommy G. Thompson
Governor

Josephine W. Musser
Commissioner

121 East Wilson Street
P.O. Box 7873
Madison, Wisconsin 53707-7873
(608) 266-3585
http://badger.state.wi.us/agencies/oc/oc_home.htm

[REDACTED]

Re: [REDACTED]

Dear [REDACTED]

We have received your [REDACTED] informational filing of an additional plan (30-year plan) for the captioned previously approved policy.

Wisconsin will be adopting the Valuation of Life Insurance Policies Model Regulation (XXX) effective January 1, 1998. This product will not work in Wisconsin and we are not accepting this filing.

Sincerely,

L. L. Schlinkert
Insurance Examiner
Bureau of Market Regulation

LLS:imk
[REDACTED]

Triple-X, Term Wars—The Sequel

by Robert Barney

Why is it that government regulators always seem to pass laws and regulations that have an impact that is the opposite of what they had originally intended? For example, in the 1960s, governments wanted to create a safety net for those in society who had financial need, so a generous welfare system was established. Years later, instead of the needy being back on their feet, there is a generation of welfare dependents who use the net as a hammock.

Guideline XXX is a similar situation. Government intentions are one thing; the outcome will be quite different. The Valuation of Life Insurance Policies Model Regulation (affectionately dubbed Triple-X) was intended to address the argument that the Standard Valuation Law had a loophole. It is argued that the loophole allows life companies to create products with insufficient reserves, permitting premiums that are too low. The loophole most prominently affects the pricing of level-term policies, and as a result, the Triple-X regulation will have the greatest impact on the reserves and pricing of level-term policies.

To summarize the perceived problem, term price wars are out of control and we may have company insolvencies. The solution: government regulators must close the loophole, thereby strengthening solvency.

To guarantee the premiums of 10-, 15-, and 20-year level-term policies under Triple-X, companies will need to significantly increase the reserves for these products. However, Triple-X comes complete with its very own loophole, permitting companies to circumvent this requirement. Because of this loophole, Triple-X becomes a cure that is much more deadly than the disease. The Triple-X loophole will result in a whole new round of price wars with a dramatic reduction in level-term insurance premiums.

Is that what government regulators expected to happen?

The October 1996 SOA meeting in Orlando featured a debate about the Triple-X regulation. In opposition to the regulation was Mark Oberhellman, product actuary for First Penn-Pacific Life. Arguing in support of the regula-

tion was Larry Gorski, chief life actuary for the State of Illinois. In that debate, Mr. Oberhellman estimated that fully guaranteed 10-year-term premiums would increase from 10% to 30%; 15-year guaranteed premiums would need to increase 20% to 60%; and 20-year guaranteed premiums by as much as 120%. Mr. Gorski did not dispute the estimates, confirming that those were the numbers he had been hearing.

It is quite clear that if the reserves and premiums for 10-, 15-, and 20-year term policies increase by the amounts suggested, life companies will be more solvent, not less solvent. In theory, Triple-X will result in higher premiums and improved solvency, all of which will protect the consumer (even if it does dramatically increase their cost for life insurance). It is a great theory, but none of that will happen.

It is no secret that the vast majority of life companies plan to take full advantage of Triple-X's five-year loophole.

Provided life companies guarantee their 10-, 15-, or 20-year level products for only five years and maintain a contractual right to increase the premium after five years, companies do not have to use the Triple-X reserve methodology. Triple-X will regulate a class of term products that will become extinct courtesy of Triple-X.

Prior to the October 1996 debate, Mr. Gorski had been publicly stating that it could not be predicted how companies would respond to the regulation. The October debate was significant in that Mr. Gorski did agree that the trend toward five-year guarantees would occur. While I was happy to see his agreement with the outcome that I had been concerned about, I was surprised to hear his view that such a product trend could not be blamed on the regulation itself. In response to a question about defective term policies—a term I had coined to describe 10-, 15-, and 20-year level-term policies with five-year guarantees—Mr. Gorski said, “If there are going to be any defective policies, it’s because of the insurance industry

and the actuaries who work for the companies. It’s not regulation Triple-X, it’s the companies and their actuaries who will make policies defective.”

It is this failure to take responsibility for the outcome of government action that leads to regulations that have the exact opposite impact of that originally intended.

In the debate, Mr. Oberhellman correctly concluded that Triple-X would not result in an increase in reserves and premiums. What Triple-X would do is shift the risk of pricing error from the company to the consumer. Instead of the life company guaranteeing the premium and accepting the risk, the risk would now be borne by the consumer. If the company needs to (or wants to) raise the premium later, it will be able to do so.

“... term price wars are out of control and we may have company insolvencies. The solution: government regulators must close the loophole, thereby strengthening solvency.”

While it is clear that the consumer will be the big loser under these conditions, this same loophole will have another less obvious impact on the term marketplace. It is going to dawn on some life companies (as it already has) that if the risk has been transferred from the company to the consumer, then there is not the same need to be conservative in pricing assumptions. A company can afford to accept more risk in its pricing simply because it is the consumer who inherits the risk. Therefore, courtesy of the Triple-X regulation, we can expect prices for term insurance to fall dramatically and a new round of price wars to begin in the term market.

As I mentioned, some companies have already realized this and have introduced five-year guarantee products that are very competitive. What dampens the impact of these new products on the current market is weak acceptance.

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Many agents are reluctant to recommend such products given that there is still a wide range of fully guaranteed alternatives for moderately higher prices. As a result, I do not believe that we will see a significant number of these products introduced before Triple-X is implemented. Until a large number of such products are being sold, I anticipate price competition for these products to remain quiet.

However, once Triple-X is implemented, that situation will change quickly. The fully guaranteed versions of these term policies will be considerably more expensive and the cost difference will push agents and consumers toward acceptance of the five-year risk. Life agents will simply get over their concern about the risk to their clients, and their warnings about the significance of the risk will abate.

Once these products become the norm and large numbers are being sold, a new round of price wars will break

"Triple-X will do for term insurance what dividends did not do for vanishing-premium whole life."

out. There will be little fear in dropping the price of 10-, 15-, and 20-year level-term policies simply because mistakes can be fixed later with price increases. Life companies without long-term interest in the term-insurance market will find that they can parachute into that market with low, low premiums at low, low risk to themselves and parachute right back out later.

Insurance regulators who think market competition will protect the consumer do not understand level-term construction. A 20-year-term plan with a level premium of 20 years is a miniature version of the whole-life concept. Compared to yearly term costs, the premium charged for a 20-year plan is higher in the early years, higher than needed to provide the actual insurance coverage. This additional premium permits the company to maintain a level premium later, even though the real cost of the protection is increasing annually.

Consumers have been willing to pay higher premiums for level-term

make the Triple-X regulation, together with many others, "standard equipment" for compliance purposes. While Triple-X has been experiencing serious troubles getting through the front door of many insurance commissions, its

because they want to be able to keep their premium cost predictable and affordable. However, should something cause them to quit their level-term policy part way through the level period, there is no cash value for the consumer to transfer to a new policy. As a result, consumers cannot make up for lost money that they have put into their level-term contract.

Let's consider an example. Suppose a 45-year-old (male preferred non-smoker) went to the current term market and purchased a \$500,000, 20-year-term policy for \$860 per year. This particular policy guarantees the level premium for the first five years. Incidentally, in the current market, a fully guaranteed policy can be purchased for \$900 per year, and one would anticipate most agents would encourage consumers to pay the extra \$40. By contrast, agents may not have much luck getting the consumer to pay an extra \$400 to \$1,000 (post Triple-X).

Ten years later we will assume that the company decides to increase the premium of the policy by 50% to \$1,290. Can the company do that? Absolutely. At age 55, the guaranteed maximum ART premium for this particular product is \$7,595. There is plenty of room for such an increase, and \$1,290 seems quite moderate compared to \$7,595.

Having received the premium increase notice, the consumer is unhappy with his existing insurer. The consumer decides to look for alternatives. Because there are only 10 more years left in the time period he wants insurance, the logical choice would be to buy a new 10-year-term policy. (This would also cost less than a new 20-year policy.) Assuming today's market, the competitive price of a 10-year-term plan for a 55-year-old would be \$1,245 (another five-year-guarantee product). No matter how you look at it, our consumer is not protected by market competition simply because he has sunk money into his old 20-year-term policy, money that he cannot extract later.

In fact, it is hard to imagine why many life companies would not want to take advantage of a perfectly legitimate opportunity to increase profits. Using this same example, it would be quite

go through the back door. The issue is far from dead.

If you would like more information on this subject, feel free to contact me at (800) 567-8376. I will be happy to provide you with a transcript of the Oc-

simple to increase the consumer's premium by 33% and argue that the resulting premium is still cheaper than what an alternative policy would cost. Of course that logic assumes the company still wants to be involved in the term market. If the company no longer cares about selling term insurance, nothing stops it from raising the premium to \$1,245 with little fear of losing its existing book of business. If the company no longer cares about keeping that book, it could simply let the premium go to the maximum premium level and watch customers stampede out the door.

While the scenarios I have suggested could be the basis for a week of debates over who would or would not do such a thing, or why you think your company would never do that, I'm sure you share my concern that somewhere, sometime (when we least or most expect it), one or more life companies will do just as I have suggested.

As you know, some consumers have been unhappy with the fact that they did not get the dividends they were promised on whole-life policies that were sold during the 1970s and 1980s. While not every life company ended up being sued, there is no doubt that everyone in the industry (with no exceptions) has paid a price for the negative publicity that this has generated.

Triple-X will do for term insurance what dividends did not do for vanishing-premium whole life. Triple-X will result in premiums that go down, not up. In exchange, companies will have the right to unexpectedly raise prices, bushwhacking consumers, who will be the ultimate losers. A consumer's right to sue, as Mr. Gorski suggested during the debate, should not be a regulator's idea of how a consumer is best protected. Sadly, when all of this does happen, the entire industry will suffer damage and lose as we are once again tarred and feathered through another embarrassing public relations debacle.

Finally, for those who think Triple-X is a dead issue, I suggest that there is more life to the regulation than you may suspect. Mr. Gorski told the October 1996 meeting that a codification regulation is under construction at the NAIC. Apparently this new regulation will

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and Mr. Oberhellman, together with a presentation I am making to insurance commissioners on this subject.

Robert Barney is President of Compulife Software Incorporated in Kitchener.

BR - SERIES

BR-10

BR-15

BR-20

North American's best term rates with five year guarantees...backed by a 110 year old company with a history of never increasing term rates or mortality costs on any of its life products.

NORTH AMERICAN COMPANY
FOR LIFE AND HEALTH INSURANCE



Since 1886

Please Note:

The front cover of the above rate card is for the BR-Series of term policies first introduced by North American Life at the beginning of 1997. These term policies are among the most competitive in the current market.

Because the initial premiums for the BR-10, 15 and 20 year level term policies are only guaranteed 5 years, nothing prevents the company from dramatically increasing premiums in year 6 and on. Even so, the company is promoting this product to agents (and it can be anticipated that agents will in turn promote this product to consumers) by stressing that the rates are "*backed by a 110 year old company with a history of never increasing term rates*".

Inside the rate book the company again reinforces this by saying "*Throughout its 110 year history, North American has never raised current term rates or mortality costs on any of its life products.*"

Having made this statement, the company offers no information or explanation about why or how it might raise those rates. Consumers are expected to blindly trust the company promise and it would appear that the company believes it can and should be trusted.

Most life agents, particularly those familiar with the vanishing premium debacle, are clearly skeptical of such promises (North American is not alone in offering these assurances). Further, most life agents are directing their clients to competing products (including those from North American) which fully guarantee the premiums for the first 10, 15 or 20 years. While these products may cost marginally more, the difference is not prohibitive. However, should Triple-X be adopted, premiums for fully guaranteed products will skyrocket (in some cases more than doubling). Under that scenario the BR type policy will become the standard in the market, unaffected by the increased reserve requirements of Triple-X.

Therefore, *Triple-X will be responsible for 5 year guarantees becoming the norm*. Agents and consumers will be tempted to accept the non-guaranteed assurances such as those offered in this rate card.

Anyone who thinks that this is in the best interest of the consumer should be forced to have the air bags, seat belts, child seats, bumpers and doors removed from their vehicles.