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Life Insurance Policy Re-Pricing: What Drove the Changes and What It Means for Policy Owners and the Marketplace

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Although they long knew it was coming, life insurance companies woke up on January 1, 2020, to a mandated New Year's Resolution – the requirement that every product offered be re-priced to reflect the latest mortality table, the 2017 Commissioners Standard Ordinary Mortality Table (CSO Tables).[1] Although it is the fifth CSO Table since the founding one in 1941–the 2020 changes are unprecedented due to the additional regulatory factors being accounted for at the same time, among them new Principle-Based Reserving (PBR) requirements, as well as Actuarial Guidelines 38 and 48.[2] These combined factors have had a significant impact on the procedures, pricing, and, ultimately, the product offerings to the consumer.

While the purchasers of life insurance may not regularly dive deeply into the pricing and actuarial aspects of the products they acquire, the 2020 changes are now on the table. This article covers the background of the CSO Tables to demonstrate the changes that have driven the industry's latest product offerings and how these changes warrant a review of current policies and a benchmarking to today's marketplace options.

REGULATION AND RESERVING BACKGROUND

In America, insurance is regulated through a national state-based regulatory system with the National Association of Insurance Commissioners (NAIC) as the standard-setting organization regulating American insurance companies. The NAIC is made up of the chief insurance regulators from all fifty states, as well as the five U.S. territories and the District of Columbia. This is the regulatory body for all forms of insurance, but this article is focused on life insurance pricing and regulation.

The first CSO Table was built and utilized in 1941. CSO Tables are developed by the American Academy of Actuaries and the Society of Actuaries (SOA) on behalf of the NAIC and project the probability of death of various age groups in a given year. This is important to life insurers as it helps guide decisions on both the development of their underwriting guidelines as well as their reserve targets. In other words, life insurers use the CSO Tables to price products and calculate how much money to hold in reserve to pay future policy benefits, e.g., death claims.

The field of actuarial science (actuaries) was big data before it was cool. Actuaries have been using math and statistics to build insurance products and estimate the financial impact on insurance companies since the industry's earliest days. U. S. based actuarial organizations such as the Society of Actuaries have Professional Conduct Codes and require members ad-

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[1] The 2017 CSO tables are available at https://www.soa.org/resources/experience-studies/2015/2017-cso-tables/.

[2] Actuarial Guideline 38 is available at https://content.naic.org/cipr_topics/topic_actuarial_guideline_xxxviii_ag_38.htm. Actuarial Guideline 48 is available at https://aboutbtax.com/O3i. *See also* Mary Bahna-Nolan, *Are You Ready for 2017 CSO?,* SCOR Views (June 2016) available at http://www.scorgloballifeamericas.com/en-us/knowledgecenter/2017cso.

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here to Applicable Actuarial Standards of Practice (ASOPs).[3] The Actuarial Standards Board (ASB) issues ASOPs. Applicability Guidelines (AGs) are an additional resource intended to direct actuaries to the appropriate ASOP in a given situation, but AGs are not guidance. Actuaries are responsible for navigating which standard applies to a certain situation. In the case of the 2017 CSO, both AG 38 and 48, to a degree, laid the framework for the PBR. For example, AG 48 helped lead the way to the elimination of reserving relief for certain off-shore captive insurance company transactions.[4]

Part of the 2020 story is not only the multiple mentioned factors coming together at the same time, but one of simply more data being utilized and factored in. The CSO Table allows for the industry (life insurance companies) to have an established standard baseline that is updated periodically to reflect changing mortality and market dynamics over time.

The earliest CSO Table used the claims experience of sixteen life insurance companies in both Canada and the United States, using policy information from a span of ten years – from 1931 to 1940. This year's changes to mortality charges use the 2017 CSO Table and mark the fourth major change of the CSO. Prior updates were made based on CSO Tables published in 1958, 1980, and 2001. With each updated CSO, more insurance companies participated than in the previous CSO Table. The 1980 CSO Table included the experience of nineteen insurance companies, the 2001 CSO 21, and the 2017 CSO 51.[5]

Each version of the CSO has been based on industry experience from a set period of time leading up to their development. For example, the 2001 CSO Table uses industry experience from 1990-1995 and the 2017 CSO Table uses industry experience from 2002-2009. The NAIC also allows each CSO a transitional period when all insurance companies are then required to have implemented the new CSO Tables into their underwriting, pricing, and reserve values.[6] This is why January 1, 2020, was the deadline for the 2017 CSO Table.

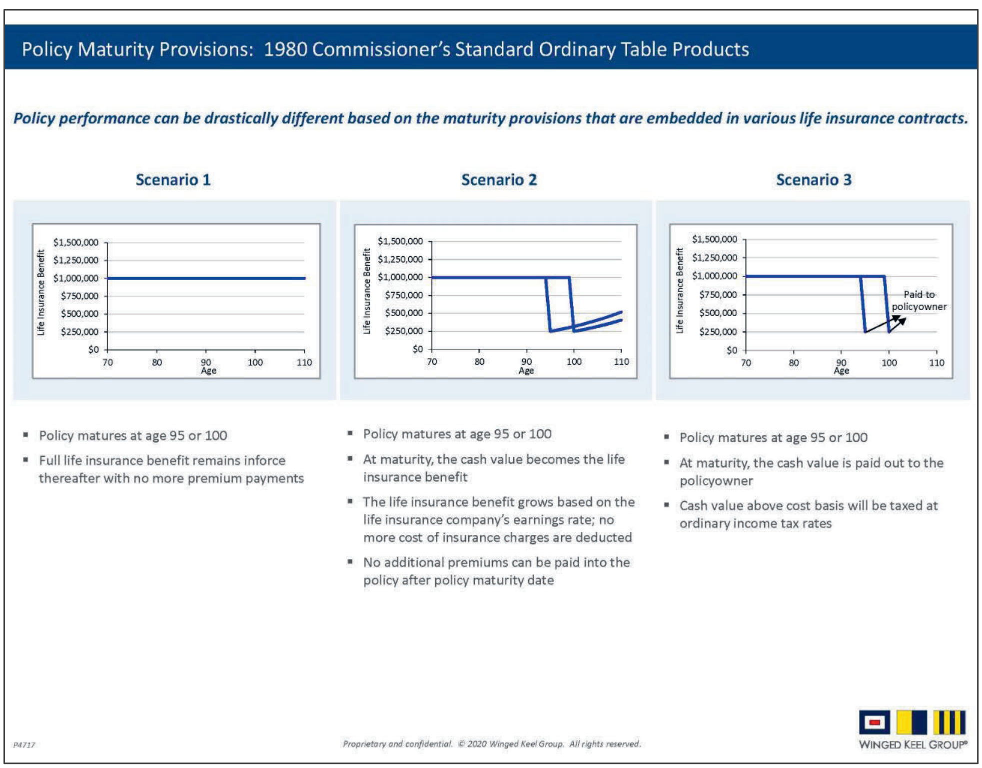
An example of a major change resulting from the 2001 CSO Table, which had to be adopted by January 1, 2009, was the extension of mortality rates to age 120. Because there were no mortality rates beyond age 100, policies issued prior to January 1, 2009, had maturity dates at age 95 or 100. The maturity provisions of older policies have very draconian results to policyowners and it would behoove all owners of contracts with issue dates prior to January 1, 2009, to review their policies, understand the maturity provisions, and explore opportunities to restructure the policies with new insurance contracts with updated mortality pricing that never mature. Below is a summary of the three standard maturity provisions that exist in pre-2009 contract.

[3] The guide on ASOPs is available at https://www.actuary.org/content/applicability-guidelines-actuarial-standards-practice-0.

[4] Jason Patterson, *There's a Slow Train Coming:Changes to Reserve Regulations and Mortality Tables May Affect The Way You Do Business,* Crump Life Insurance Service Articles & Materials Hub (Oct. 2019).

[5] Report on the 2017 CSO and 2017 CSO Preferred Structure Table Development available at https://www.soa.org/globalassets/assets/files/research/exp-study/research-2017-cso-report.pdf.

[6] Insurance Technologies, *News Events Snapshot*, (Jun. 19, 2018) available at https://insurancetechnologies.com/NewsEvents/SnapShot/Snapshot_6-19-2018.shtml.



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Since 1996 there have been a multitude of changes in the life insurance business that are only now getting captured in the new CSO Table 2017 including: underwriting practices (e.g., the use of multiple preferred categories), average policy size (which has grown), a move to term insurance policies (from permanent insurance products), and longevity. Further, there was more data on the impact of smoker/nonsmoker classifications, policies issued at older ages, as well as at substandard rating (table ratings) classifications. Further adding to the dramatic data difference between the last two tables is the level of insurance benefit exposure studied. The amount of insurance exposure tracked under the 2017 CSO Table is greater than five times the level of the 2001 CSO ($30.7 trillion to $5.7 trillion).[7]

The resulting difference between the 2017 and 2001 CSO Tables are lower mortality rates, as life expectancies have improved over the sixteen years between versions. Given this reality, it is expected that policies issued in 2020 and beyond will have generally lower mortality rates. For policies built for cash value accumulation purposes, this likely will result in an increase in the early year accumulation values.

Naturally, each life insurance company has their own actuarial experience and statistical analysis that drives how they assess risk, and price products - the CSOs are simply used as a common base and allow the NAIC to demand updated pricing to match current experience. The new CSO determines the setting of the maximum seven-pay premium as well as the maximum premiums to qualify as life insurance under the Modified Endowment Contract (MEC), and Definition of Life Insurance guidelines.[8] This had the effect of requiring slightly more life insurance benefit when you are maximum funding a policy but has also resulted in lower cost of insurance charges. In addition to changes driven by the updated mortality table, they also had to consider the creation of a new method of calculating reserve requirements called the Principle-Based Reserve formula (PBR). The PBR defines how a life insurance company is required to book their reserves (money set aside to pay future claims that come due) and falls under NAIC's ''Standard Valuation Model Law (SVL).''

More specifically, the newly required PBR formulas aim to eliminate a viewed reserving disparity among product lines at life insurance companies.[9] Under the (now old Standard Formula) rule-based approach, inadequate reserves for one (inadequate) insurance product line could be offset by another (adequate) line to satisfy the reserving requirements. The PBR solution aims to remove this ''balancing act'' reserve calculating by requiring life companies to use the higher of one of two reserve factors. The first allows companies to use prescribed factors while the second reserving option allows companies to base their reserves on a number of future economic factors, such as the insurers' credible mortality and expense experience, the company financial strength, and the investment experience of the company. It is believed that replacing the rule-based (old formula) approach with a principal-based (new formula) approach will allow more security for the life insurance consumer. Again, the NAIC's goal for updating to the PBR formula is to create reserving requirement parity across product lines at life insurance companies and enhance consumer protection.[10]

MARKETPLACE CHANGES

It is an interesting time to be a life insurance company. Although mortality costs are down, the low-interest rate environment continues to put pressure on companies to innovate new product offers that are viable for the insurance company, and attractive to the end consumer. The result is an evolution of more and more products whose performance are driven by factors other than the yield on the insurance companies' general account (whole life dividends and universal life crediting rates).

These product innovations include institutionally priced separate account products that allow policy owners to allocate to a wide array of asset classes to support their insurance benefit. This includes guaranteed insurance products that have both separate account protection and upside potential, and higher early year cash values in max funded policies. Many of the new products and features provide an opportunity for clients to significantly enhance the economics of their existing insurance portfolios.

CONCLUSION

Life insurance has unique tax benefits (tax-deferred growth of cash value in permanent policies and tax-free insurance benefits in both term and permanent policies), that play an important role in risk mitigation and planning strategies for institutions and families.

We are pleased to see the key industry organizations and regulatory bodies continuing to promote enhancements to the regulatory and reserving requirement associated with life insurance products. This proactive consumer advocacy is great for the market and is driving innovative product designs that allow life insurance to continue to play a critical role in the financial security management of policyowners.

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[7] The report on the 2017 CSO and 2017 CSO Preferred Structure Table Development is available at https://www.soa.org/globalassets/assets/files/research/exp-study/research-2017-cso-report.pdf.

[8] Insurance Technologies, *News Events Snapshot*, (Jun. 19, 2018) available at https://insurancetechnologies.com/NewsEvents/SnapShot/Snapshot_6-19-2018.shtml.

[9] Ernst & Young, *Technical Line NAIC Final Guidance:How principle-based reserving will affect life insurers* (June 16, 2017).

[10] Kris Defrain & Dimitris Karapiperis, *Principal Based Reserving Pilot Project and Implementation Process*, The NAIC and the Center for Insurance and Policy Research (CIPC) Newsletter, (Mar. 2017).

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