

Rerouting the Regulation of Insurance: The Actuaries' Perspective

An American Academy of Actuaries

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Panel

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Member, American Academy of Actuaries

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Member, American Academy of Actuaries



Introduction

Henry Siegel
FSA, MAAA



Agenda

- Cande Olsen, FSA, MAAA, New York Life
 - Speed-to-Market
 - As it applies to life insurance companies selling life, annuity, disability and long term care policies
 - Background and current status on approaches to this issue
 - Examples will focus on life insurance policies since that is the core business of the life insurance company
- Steve Lehmann, FCAS, MAAA, Pinnacle
 - Price Controls
 - As it applies to property/casualty companies
 - Background and pros and cons on the use of price controls



Speed-to-Market for Life Insurance

Cande Olsen
FSA, MAAA



What is “Speed-to-Market”?

- Slang term for how much time it takes to get an insurance product to the marketplace
- In other words, the time:
 - from when an insurer is *ready* to sell a product
 - until the time that product is *approved* for sale



Average Product Approval Time *

	<u>All Products</u> All 50 States	<u>Life Products</u> In 5 States Where Companies Surveyed Do the Most Business
For new products and major changes to existing products	3-4 months	6-7 months
For minor changes to existing products	2-3 months	

* Based on the responses of 129 companies participating in the UMass Study (2002 data). These companies represent 30% of premium income for all life insurers.

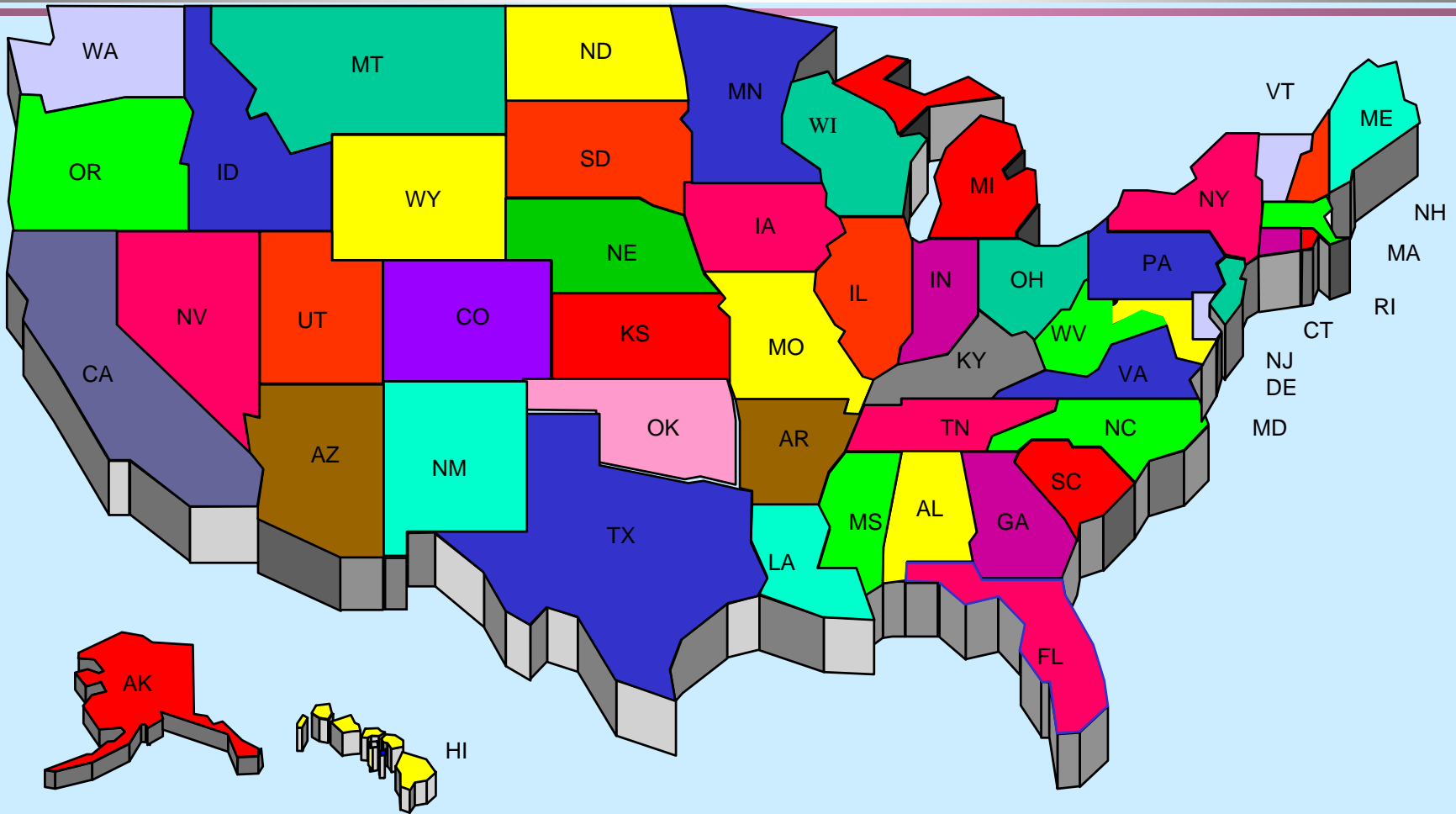


Why Does Product Approval Take So Long?

- Products must be filed in the state where they will be sold
 - Most states require “prior-approval”
 - Some states allow “file-and-use”, but there is a risk
- Life insurance contracts are complicated long term contracts
- Review requires legal and actuarial expertise not available in large supply



And, to sell the same product at the same price in ALL 50 states,
the product must be filed in ALL 50 states



Why Does Product Approval Take So Long?

- Each state may have different requirements
- Even where states have the same requirements they often interpret them differently
- Often these interpretations are not published, called “desk drawer rules”



Difference Between Life Insurance and P/C Coverages

- Life insurance products are designed and priced for the long term
- P/C products are usually designed and priced for only one year
- Some P/C coverages are required:
 - Auto insurance and Worker's Compensation are required by law
 - Homeowners insurance is required by mortgage lenders
- Life insurance purchases are discretionary



What is a Life Insurance Product?

- Examples of general life product *categories*:
 - **Term Insurance** –for a limited number of years, with no cash value
 - **Permanent Insurance** –for the life of the insured, with a cash value
 - **Whole Life** – Fixed death benefit and a level premium
 - **Universal Life** – Death benefit and premiums that vary from year to year at the option of the insured
 - **Variable Universal Life** -- Death benefit that varies with the *actual* investment performance of the funds invested in the policy and a premium level that varies at the option of the insured



Product Design Features

- Enhancements to the basic product that respond to a customer need
- A myriad of product design features available
- Examples
 - Term Insurance that is automatically renewable at the end of its term
 - Whole Life product that has lower premiums in the early years
 - Universal Life that insures several people and pays on the death of the last insured to die



What are Policy Provisions?

- State laws require a policy to include certain *provisions* that provide *consumer protections* for the policy owner
- Examples
 - rights and options of the policy owner
 - limits on the rights of the insurer
- A life insurance policy is a contract between an insurer and a policy owner. The terms of the contract are set forth in a policy form.



Examples of Specific Life Insurance Policy Provisions

- **Free Look Provision** – the number of days the policy owner can take to examine the policy
- **Suicide Exclusion Provision** – the number of years that the company can refuse to pay the death benefit if the insured commits suicide during that time



What are Life Insurance Regulatory Concerns?

- Will product design features and policy provisions last for the long term?
- Are the features fair and equitable? Most importantly, is the cash surrender value calculated in a fair and equitable way?
- Are the features and provisions fully disclosed and understandable to the average person?



What Can be Done to Speed Up the Product Approval Process?

1. Uniform product requirements for all 50 states
2. Single point of filing
3. Streamlined administrative process



Efforts Underway to Reduce Speed-to-Market Time



NAIC Work Effort

- SERFF (System for Electronic Rate and Form Filing)
 - Standardized electronic platform for new product filings
 - 48 states are using it; Florida uses its own system; Rhode Island doesn't use it and California only uses it for P/C.
 - Some states do not allow all products to be filed under SERFF
 - Some states do not utilize all of SERFF's features



NAIC Work Effort (cont.)

- Interstate Compact Model Act
 - Establishes a commission responsible for:
 - Development of uniform product standards
 - Implementation of a single point of filing
 - Compact goes into effect after 26 states (or states representing 40% of premium volume) adopt the Model (only for the states that adopt it)
 - 6 states have adopted, introduced in another 11 states



NAIC Work Effort (cont.)

- Creation of Drafts of Uniform Product Standards
 - 2 standards “completed”
 - 4 standards in process
 - Goal of 24 standards to be completed by year end
 - Still many more standards left to complete
 - Standards not final until adopted by Compact Commission



NAIC Process to Create Uniform Standards

- The NAIC has made considerable progress, but many in the industry are concerned that it is not fast enough, and that it may never meet the goal of uniformity



Process Used in New York to Make Requirements More Predictable

- Developed list of requirements for each product type
- Each requirement supported with citation to law, regulation or other published rule
- Eliminated “Desk drawer rules” by either publishing them or disallowing them
- Process took 2 years
- Top-down process driven by Superintendent



Process Used in New York to Make Requirements More Predictable

- New process has eliminated ambiguity
- Reduced average product approval time for one company, New York Life, from 1 year or more to 2-4 months



ACLI Recommendation for Federal Legislation to Promote Speed-to-Market

1. Encourage all states to adopt NAIC Interstate Compact Model Law with national standards by pre-empting state's right of pre-approval of product filings
2. Make file-and-use less risky for companies by disallowing desk drawer rules and requiring consistent interpretation of model laws in effect in multiple states
3. Encourage the Compact to adopt reasonable standards by continuing to allow companies to use the option of file-and-use under current individual state standards



Costs of 50-State Product Approval Process

- Intangible Costs
 - Inability to offer a product to customers in one state that is already available in another state
 - Potential for compliance errors due to tracking and administration of 50 different sets of requirements
 - Diversion of staff time of state regulators away from other things



Costs of 50-State Product Approval Process

- Measurable Costs
 - Filing fees
 - Cost of in-house personnel, outside consultants, and systems costs related to product design, administration, tracking laws and preparing filings for all products in 50 states
 - Average annual cost (per UMass Study) ranges from less than \$100,000 in some small companies to several \$ million in the largest companies
 - Costs are passed on to customers in terms of increased premiums



Price Controls

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Types of Rating Laws

- State-made Rates
- Prior Approval
- File and Use
- Use and File
- Open Competition



Ratemaking Standards

- NAIC Property and Casualty Model Rating Law
“Rates shall not be inadequate, excessive, or unfairly discriminatory.”
- Statement of Principles Regarding Property and Casualty Insurance Ratemaking,
Casualty Actuarial Society, May, 1988.



Ratemaking Standards (continued)

- Actuarial Standards Board promulgates various standards dealing with Property and Casualty Insurance ratemaking.



Benefits of Open Competition

- Insurers can respond promptly to changing conditions
- Insurance Availability is enhanced
 - Size of residual market under open competition: 3.3%
 - Prior approval: 5.8%
 - State-made/mandatory bureau: 15.3%
- Prices by class will more closely reflect expected claim costs and expenses



Benefits of Open Competition (continued)

- Innovation is stimulated
- Lower expenses for companies and regulators
- Rates are less subject to political pressure



Drawbacks of Open Competition

- Insurers may focus on most desirable risks
- Affordability concerns for the highest cost risks
- Increased product variation may complicate comparison shopping



Drawbacks of Open Competition (continued)

- Increased competition may cause rating bureaus to withdraw and hurt small insurers
- Transition issues from prior approval to open competition



Possible Exceptions to Open Competition

- Lines of Business with little or no price competition (e.g. Title Insurance, Credit Property)
- Workers Compensation
- Residual market mechanisms



Research Studies on Open Competition vs. Prior Approval

- 1977 Dept. of Justice Study- The Pricing and Marketing of Insurance, Jan. 1977
- Competition in the Property and Casualty Industry, VA Ins. Bureau, Jan. 1978
- Open Competition vs. Prior Approval: Property and Liability Loss Ratios, Concentration Ratios and Operating Profits, IL Ins. Dept., Nov. 1979



Research Studies on Open Competition vs. Prior Approval

- The Open Rating Law and Property-Liability Insurance – An Evaluation of Insurance Price Regulations, Feb. 1977
- Annual Report to the Illinois General Assembly on Insurance Cost Containment, Illinois Dept. of Insurance, April, 1999



Research Studies on Open Competition vs. Prior Approval

- Insurance Price Deregulation: The Illinois Experience, Stephen P. D'Arcy, May, 2001
- Insurance Rate Regulation in the 20th Century, Scott E. Harrington, 2000
- Report of the Advisory Committee on Competitive Rating to the NAIC, NAIC Proceedings, 1980, Vol. II



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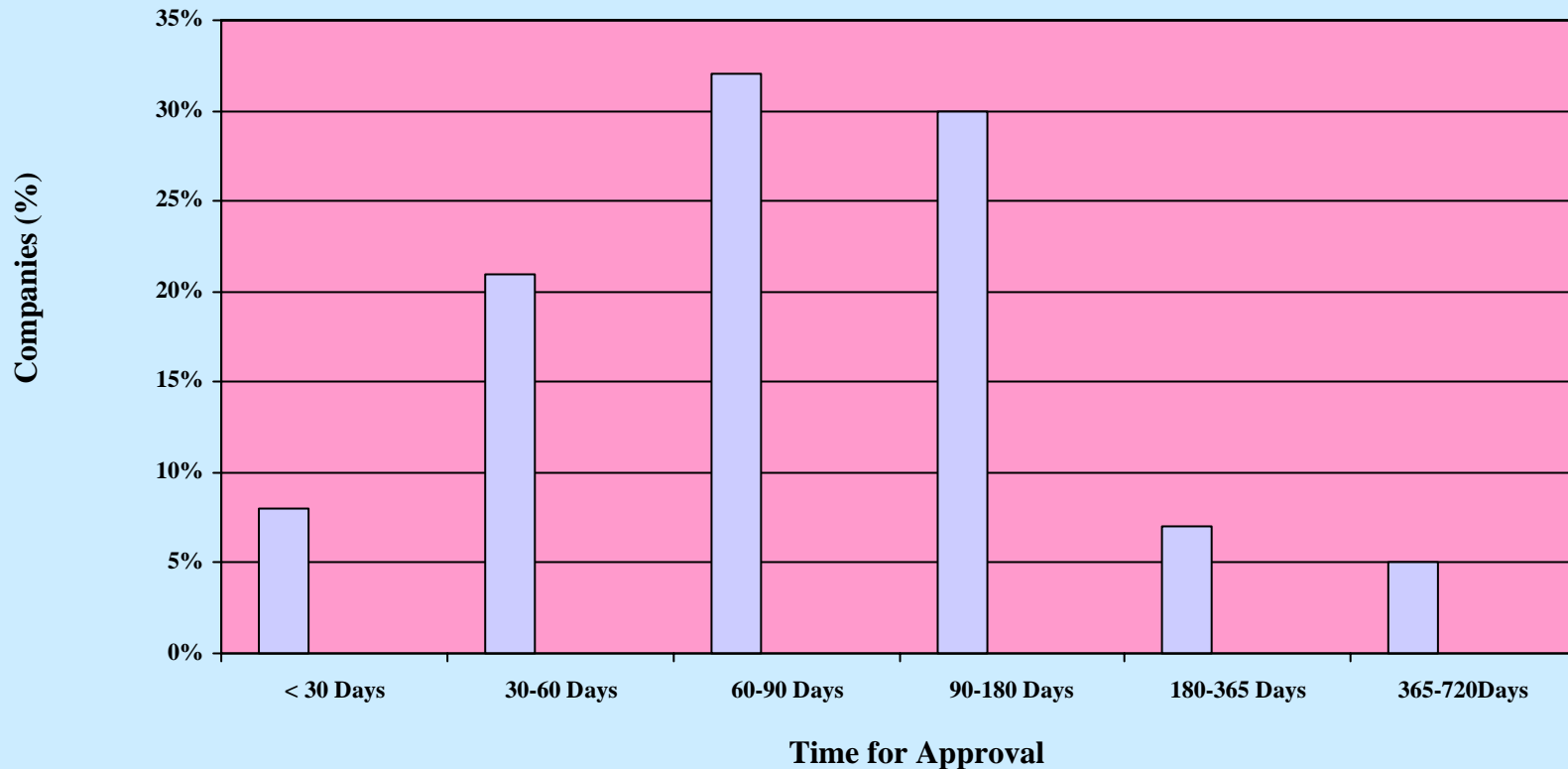


Speed-to-Market Appendices



Appendix 1

Distribution of Approval Time – All 50 States New Products & Major Changes to Existing Products



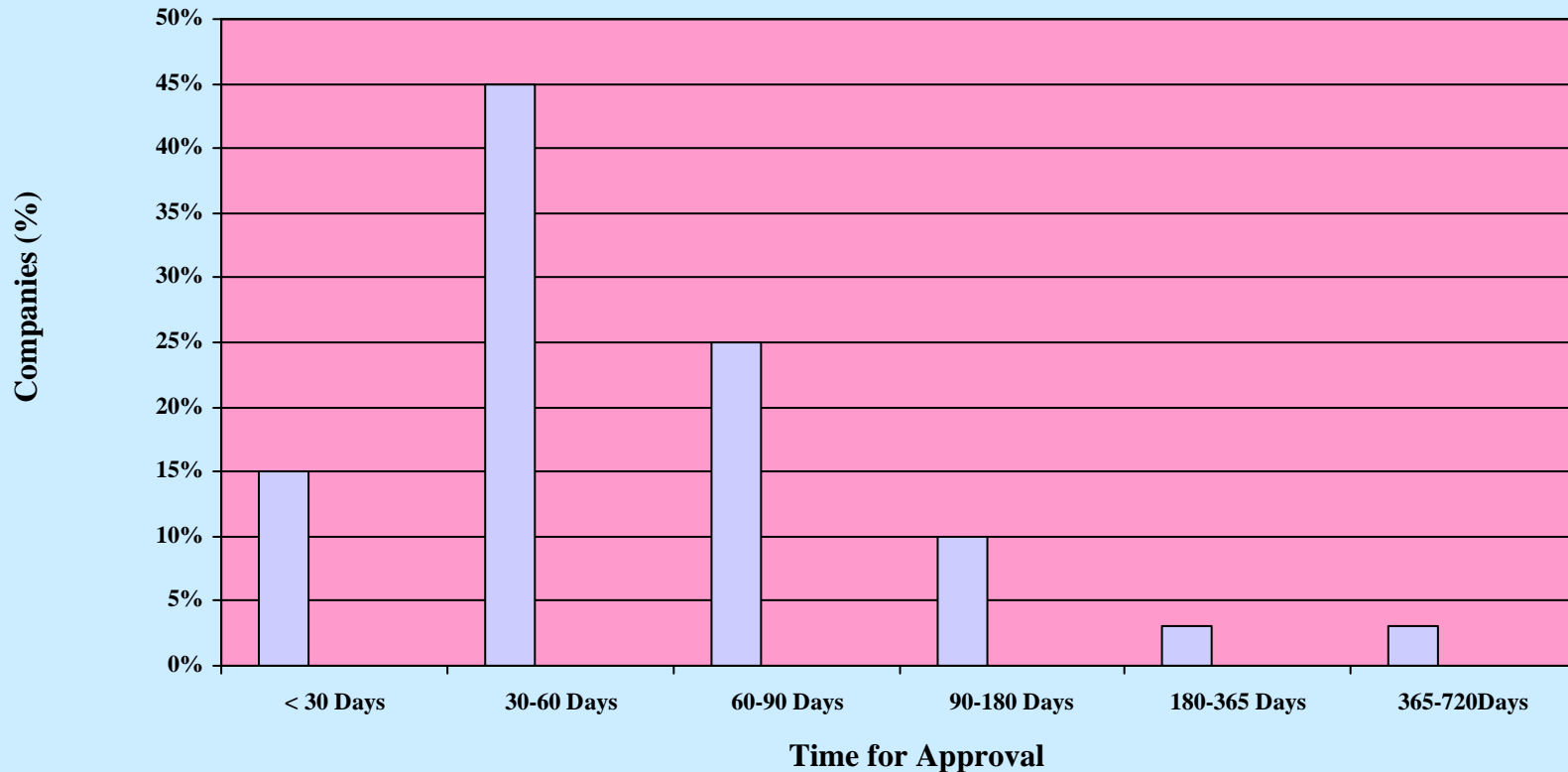
Average Approval Time for all products: 109 days

Survey taken in 2002



Appendix 2

Distribution of Approval Time – All 50 States Minor Changes to Existing Products



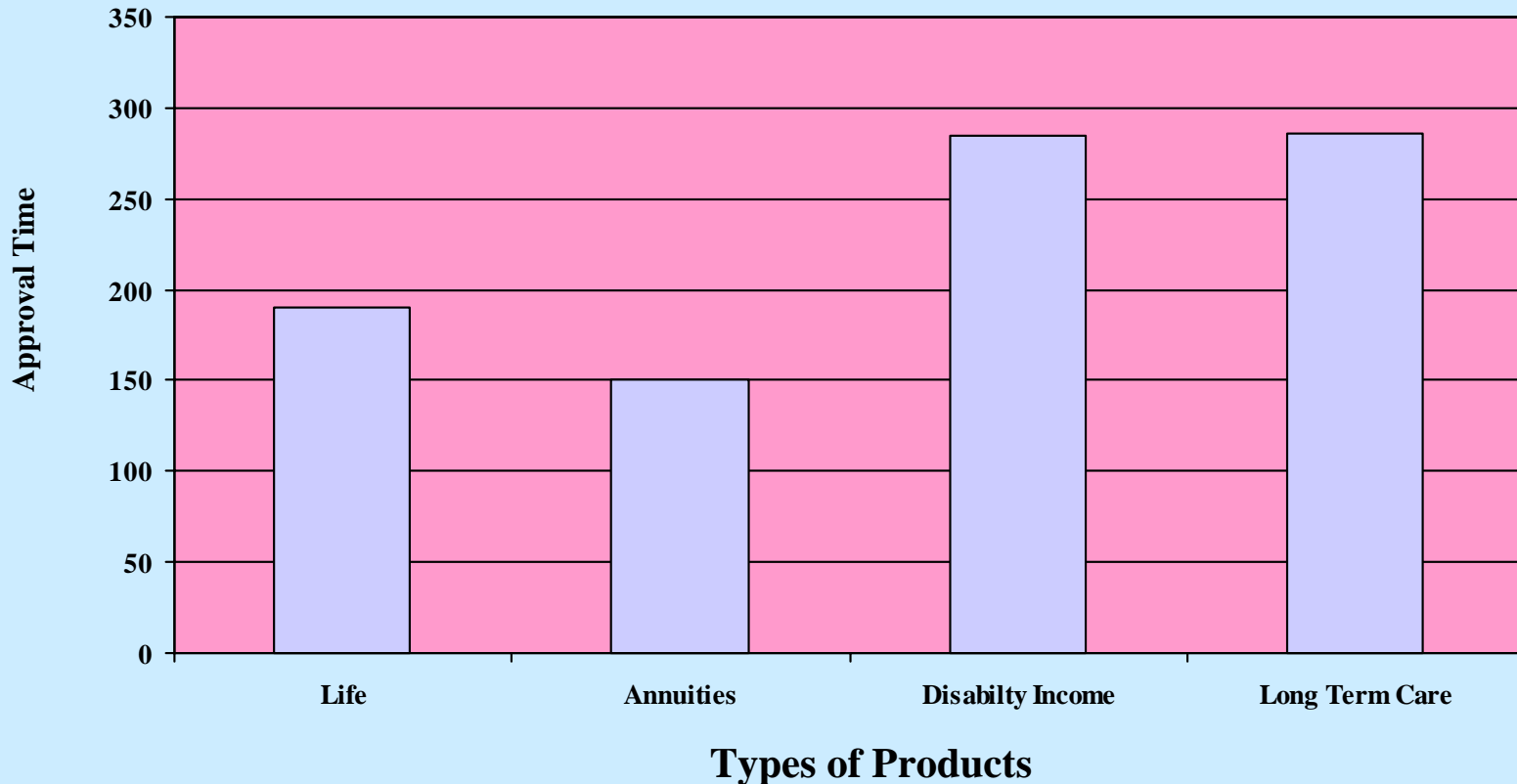
Average Approval Time for all products: 81 days

Survey taken in 2002



Average Approval Time

Five States Where Most Business is Written



Average Approval Time for Life: 190 days

Survey taken in 2002



Examples of Life Insurance Policy Provisions

- **Free Look Provision** – the number of days the policy owner can take to examine the policy and still return it for a full refund of the initial premium paid (10 to 30 days)
- **Suicide Provision** – the number of years that the company can refuse to pay the death benefit if the insured commits suicide during that time, to protect the company against purchase of coverage with intent to commit suicide (1 or 2 years)
- **Interest on Death Proceeds** – minimum interest rate that will be credited on payment of death benefits from the date of death (or proof of death) until the payment is received (e.g. specific interest rate for all companies or rate tied to another rate in the policy)



Examples of Life Insurance Policy Provisions

- **Minimum Cash or Account Value** – disclosure of the minimum cash value available at different policy durations if policy owner wants to cash in the policy
- **Policy Loan Provision** – grants the policy owner the right to take a loan against the cash value of the policy, subject to certain conditions such as the interest charged on the loan and the maximum amount that can be borrowed



Appendix 5

Examples of State-by-State Differences

- Differences in laws that are relatively easy to comply with
 - Different suicide provisions (Colorado is 1 year and NJ is 2 years)
 - Different free look periods (Connecticut is 10 days and North Dakota is 20 days)
- Differences in interpretations of the same law
 - Oregon requires different assumptions in the calculation of minimum cash surrender values even though the calculation is based on the same law effective in other states
- Single state outliers with different laws
 - Pennsylvania requires the policy loan value on Universal Life to be calculated based on a projection to year end



Appendix 6

STATE'S ADOPTION OF INTERSTATE COMPACT LEGISLATION

(as of May 24, 2004)

