Term Insurance Update

Southeastern Actuaries Conference

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Agenda

Market Overview

Return of Premium Term

Securitization

Regulatory/ Professional Initiatives

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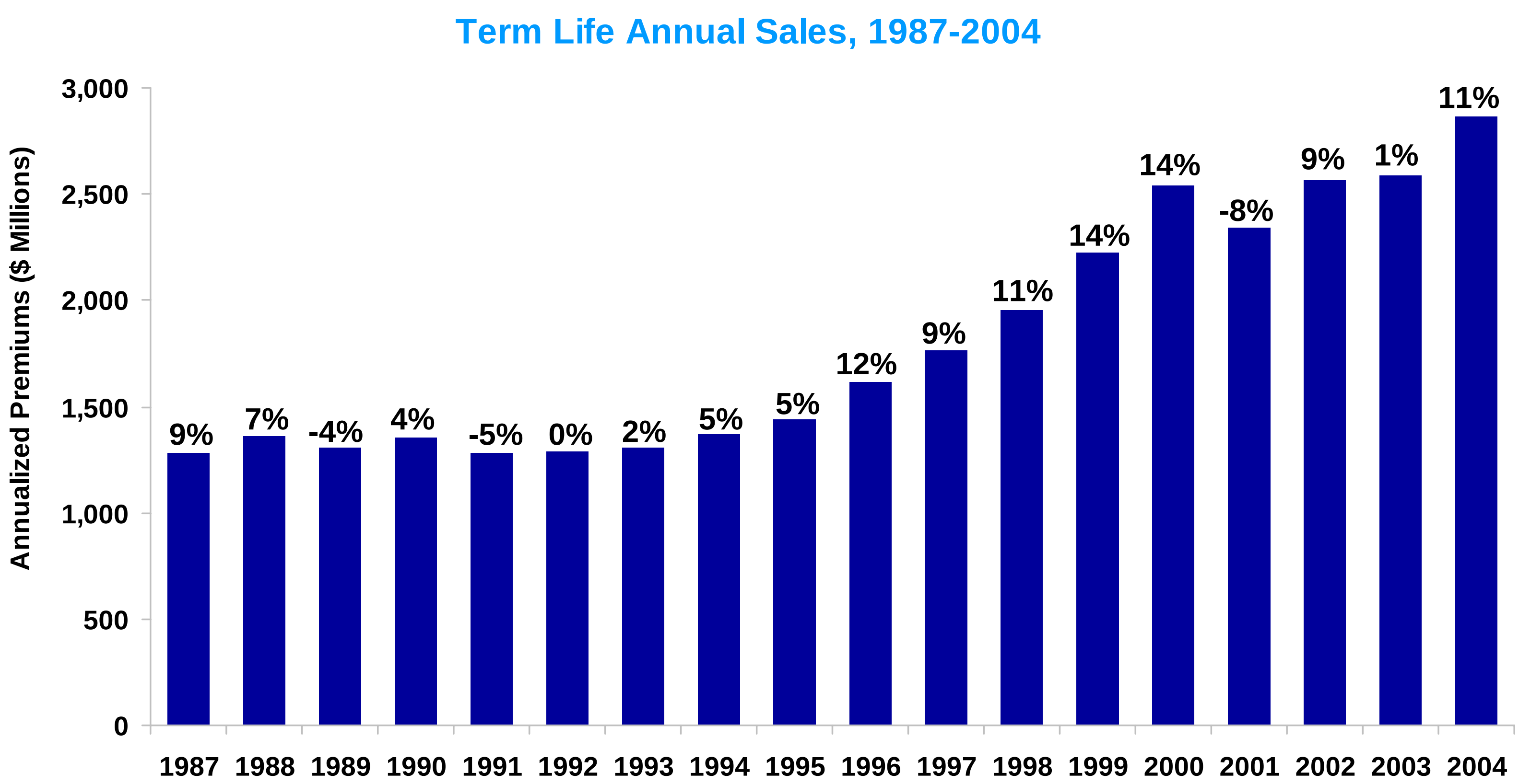
Term insurance has captured an increasing market share during the past several years



Market share has increased from 13% in 1993 to 23% in 2004

Source: Morgan Stanley and LIMRA

2004 growth was concentrated in the larger players, and there is considerable variation by company

Term Life Issued 2004			
Rank	**Group Name**	**Issued (Billions)**	**Change**
1	AIG Life Group	$139.7	60.4%
2	Citigroup	87.3	7.3
3	Northwestern Mutual Group	68.9	4.0
4	State Farm Group	59.1	9.5
5	Protective Life Corp.	57.8	-25.7
6	AEGON USA, Inc.	54.7	-2.0
7	Genworth Financial Group	53.2	-5.2
8	Legal & Gen America Inc.	49.4	13.8
9	New York Life Group	47.8	13.4
10	Prudential of America Group	47.2	17.2
	Top 25 Life Writers	1,027.8	9.0
	Total U.S. Life Industry	1,305.1	5.1

Source: A.M. Best Co.

Product changes are evolutionary, not revolutionary

- The 10, 20, and 30 year level term remain the core products
- 2001 CSO conversions are largely complete
- More companies are developing ROP plans
- Some companies have increased rates; others have decreased rates
  - Decreases largely for preferred and longer-term plans, more toward longer-term plans
  - Rate changes are targeted, rather than across-the-board

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Product changes are evolutionary, not revolutionary

- Product pricing is buffeted by competing forces
  - Lower reserves for 2001 CSO
  - Higher reinsurance costs
  - Lower interest rates
  - More conservative views on ultimate lapse and mortality slope
  - Extreme competition

Reinsurers have "tightened-up"

- They have been subject to same forces as the direct companies
- In addition, they have concluded that underwriting at several clients has not been appropriate
- Reinsurers' responses
  - Raising rates, particularly for older ages
  - More underwriting audits
  - Stronger treaty language
  - Denying claims
- Direct companies' responses
  - Higher premiums and/or lower margins
  - YRT instead of coinsurance
  - Excess over retention instead of quota share

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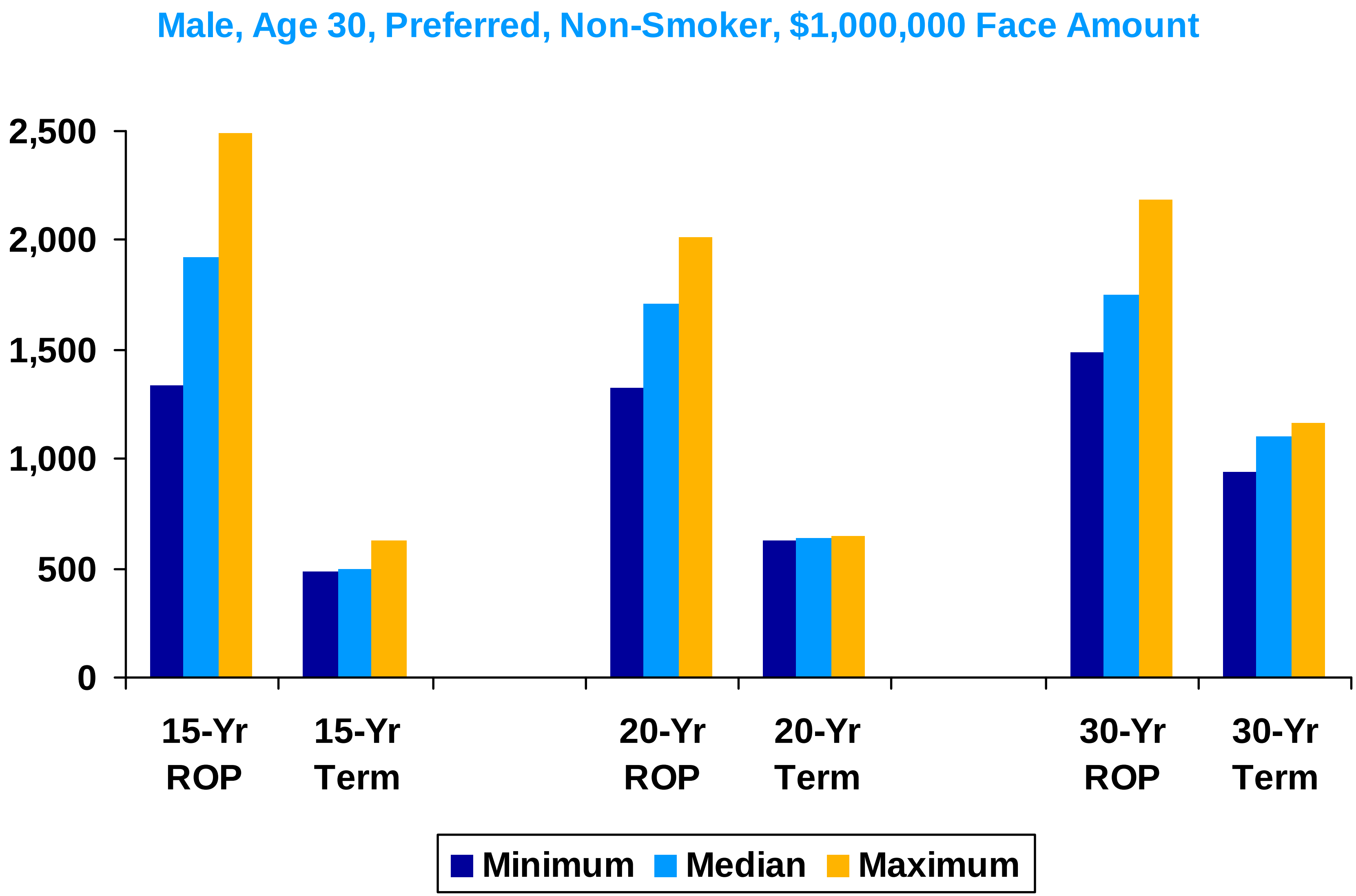
ROP Term typically provides for the return of an increasing percentage of premiums paid if the policy is cancelled

Sample Return of Premium Percentages			
End of Policy Year	**15-Year Term**	**20-Year Term**	**30-Year Term**
1–5	0%	0%	0%
6	5	3	1
10	25	15	5
15	100	50	15
20		100	25
30			100

There is a wide range of ROP Term premium rates, especially for the shorter term periods



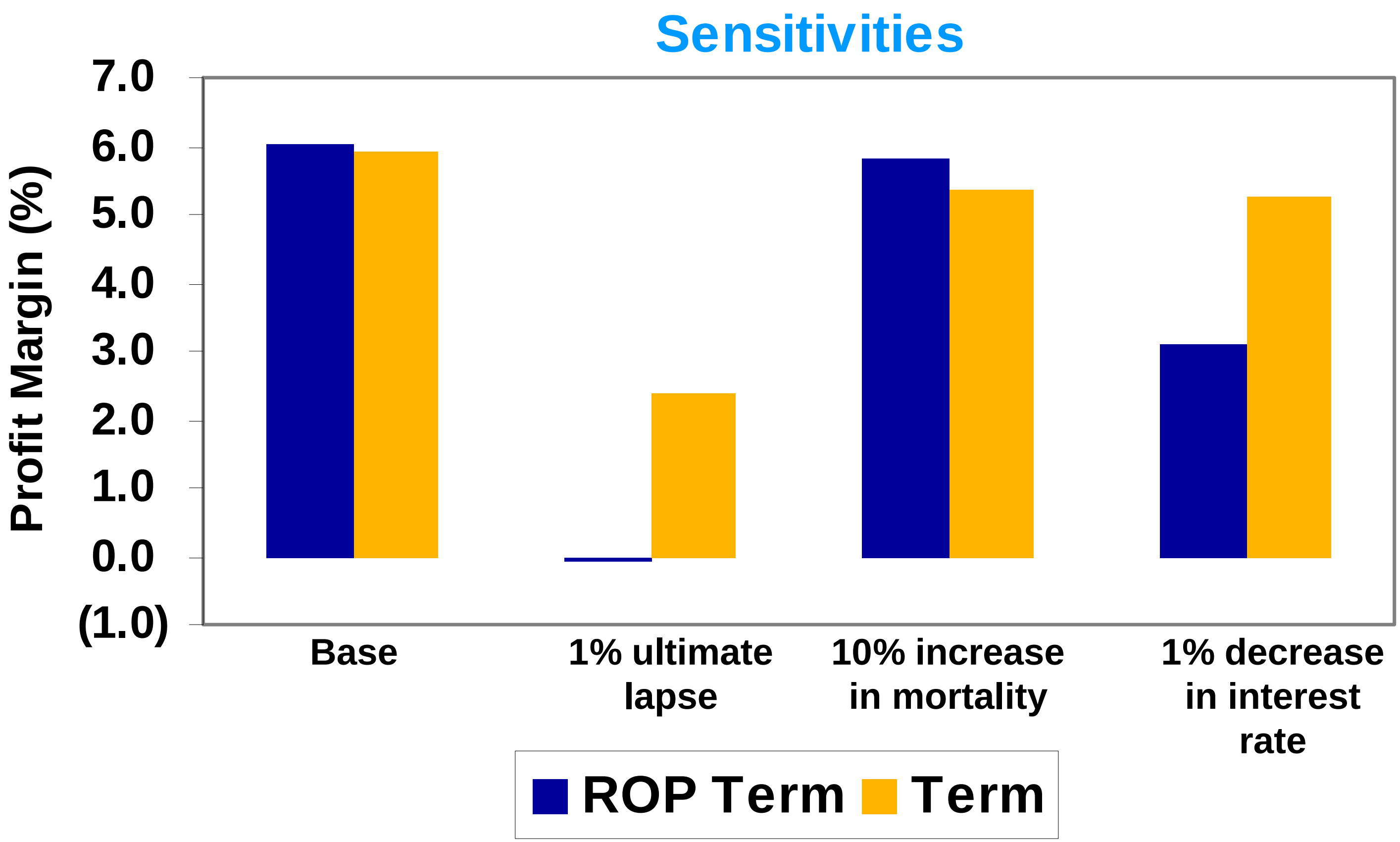
Regulatory Issues

- Most states are fine with the concept
- Some states require compliance with Section 8 of the SNFL (“Consistency of Progression of Cash Surrender Values with Increasing Policy Duration” a.k.a., “Smoothness Test”)
  - The ROP benefit can be designed to pass the Smoothness Test
- The following states tend to ask more questions (and therefore may not approve the product)
  - California, Florida, Minnesota, New Jersey, New York, Oregon, Pennsylvania, South Carolina, Texas, Utah and Washington

Pricing Issues

- The ultimate lapse rate is the key assumption
  - Wide range seen in the marketplace
- ROP Term is more sensitive to the interest rate assumption than Term without ROP
- Reinsurance is not generally available
  - Complications can arise when the base term benefit is reinsured, but the ROP Term benefit is not
- Reserves for ROP Term are higher than for regular term
  - Pure endowment
  - Greater of XXX reserves and cash value
  - Steep cash value pattern
  - An improperly designed ROP pattern could require a company to hold additional statutory reserves

Sensitivity Tests



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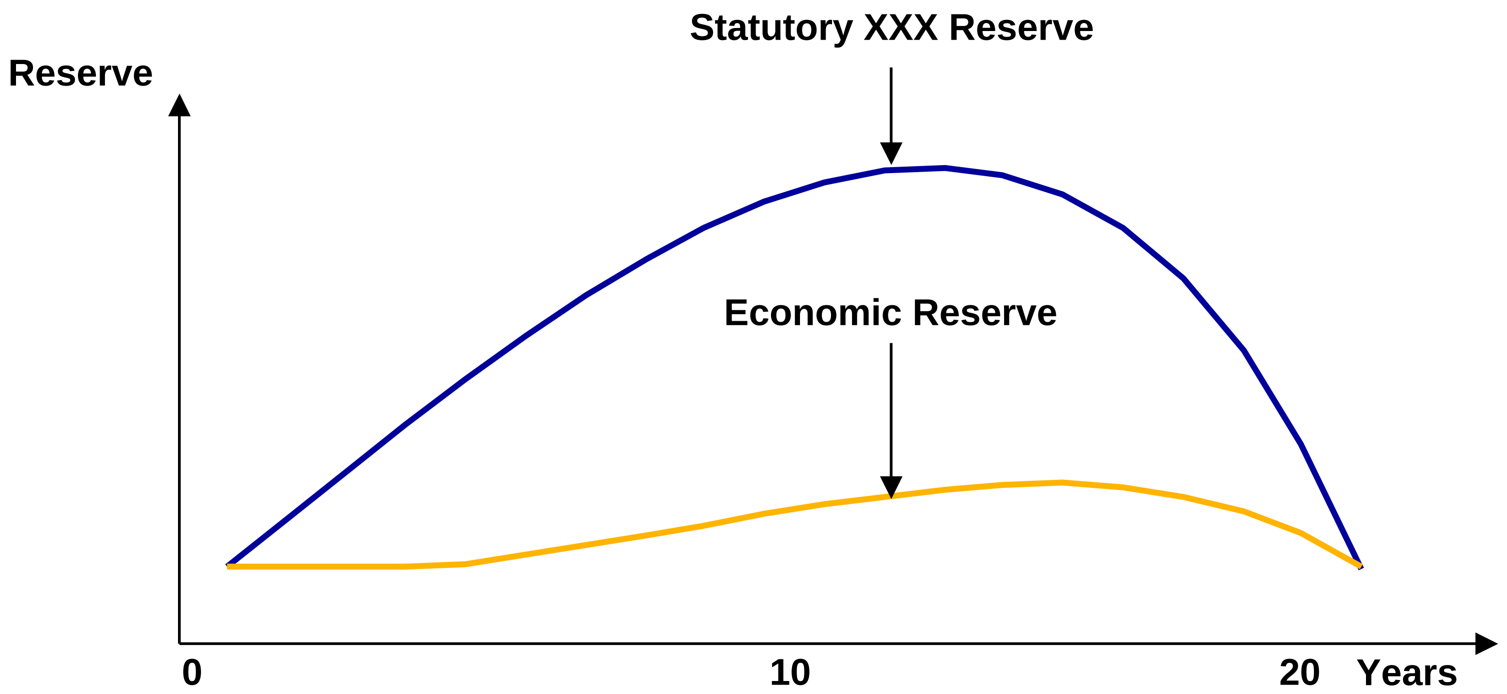
Securitization of term insurance redundant reserves

Regulation XXX Results in Significant Long-term Reserve Strain for Companies in the Term Market



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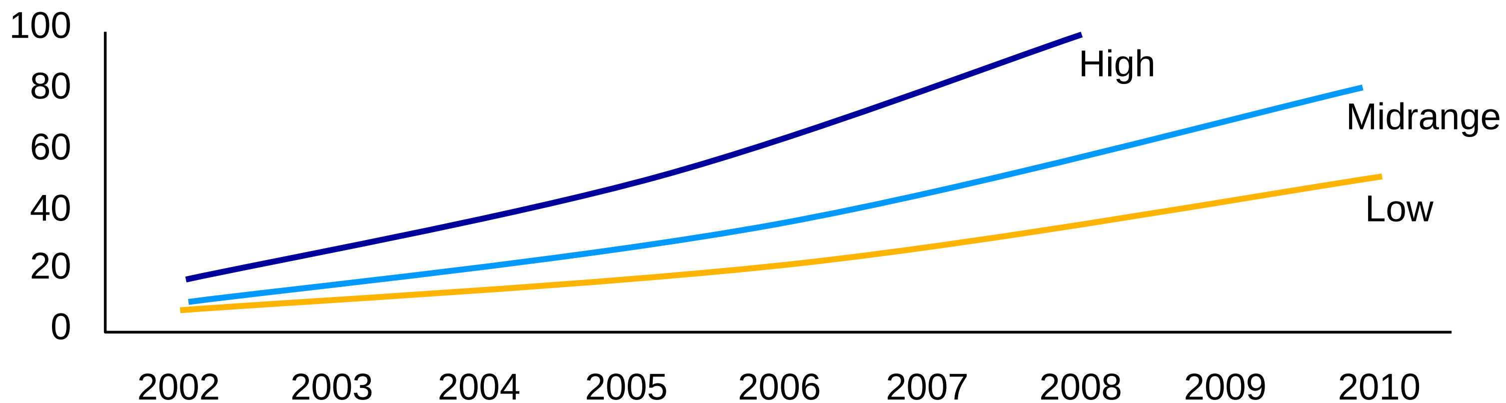
Securitization of term insurance redundant reserves

- Moody's estimates that industry LOC demand for XXX reserve credit could increase to roughly $45 billion by 2007

Forecasted Reinsurance LOC Market Demand
XXX Reserves Only ($B)



Source: Moody's Investors Service.

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Reinsurance has traditionally been preferred for managing reserve and capital strain

- Insurers have historically relied on offshore reinsurance to manage reserve and capital strain on selected insurance products; for example:
  - Term insurance subject to Regulation XXX
  - Universal life insurance subject to Guideline AXXX
- Generally requires LOC or other collateral
- Two main risks exist with regard to reinsurance LOCs:
  - Lack of reinsurance LOC capacity, particularly in future years
  - Uncertainty regarding LOC costs

Securitization is gaining momentum as an alternative to reinsurance

- Insurance companies are no strangers to the capital markets; property/casualty firms have used cat bonds for years to mitigate natural and catastrophic risks
- Securitization provides almost unlimited capacity
  - However, capital markets have a learning curve in order to become familiar with underwriting risk
  - Transactions to date have been private placements with significant life industry participation
- Costs to insurer include
  - Difference between interest rate on assets purchased with debt proceeds and debt interest rate
  - Fee paid to credit wrapper
  - Transaction costs

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Securitization is gaining momentum as an alternative to reinsurance

- For now, high transaction costs make securitization most viable for large blocks of business
  - Fixed nature of many costs leads to greater economies as deal size increases

Securitization of term insurance redundant reserves

- Key risk to investors is that assets held in trust are needed to pay benefits
  - Primary risk factor is mortality
- Modeling requirements:
  - Accurate model of securitized term business
  - Ability to stress test mortality assumption in various ways
    - — Varying mortality slope
    - — One-time catastrophic events
    - — Stochastic mortality?
- Goal is to demonstrate that securitization structure can withstand substantial adverse deviations in mortality experience

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The issue of redundant reserves under 1980/2001 CSO has reached "tipping point" with UL products with secondary guarantees

- A revised AG38 was developed this year to apply "XXX" reserves to all ULSG designs
- The compromise is that the new formula sunsets in April 2007, by which time there is supposed to be "principle-based" reserves or interim step providing relief
- These interim/ultimate solutions also will apply to term

The AAA formed a Universal Life Working Group (now Life Reserve Working Group) to develop principle-based approach for statutory reserves and capital requirements

- Has achieved initial target of proposed approach, including model regulation and actuarial guideline, for December NAIC meeting
  - Proposes deterministic scenario-based reserve supplemented by stochastic scenarios where appropriate
  - Company specific assumptions can be used, but credibility needed — causes need for more industry tables
- Lots of details yet to be worked out

A project oversight group has been formed to develop preferred valuation mortality tables

- Prompted by request at June 2005 NAIC meeting
- Representatives from SOA, AAA, regulators, and industry groups
- Will use SOA 2002-2004 experience study that includes preferred experience
  - Experience study to be done early 2006
  - VBT table to be done late 2006
  - New valuation table(s) to be done early 2007

The ACLI, not content to wait for 2007, has developed a preferred/standard "split" for the 2001 CSO table

- Table developed by Michael Taht of Tillinghast
- Report and proposed regulation submitted for December NAIC meeting
- Table uses assumptions of preferred prevalence and ratios to standard, and conservation of deaths, to split the table

Ratio of Preferred to Aggregate Nonsmoker PV Reserves for 20-Year Term		
	Male	**Female**
Select & Ultimate	80%	82%
Ultimate	89	94

Other items of interest relative to term

- The SOA has an RFP for surveying lapses and mortality beyond the level term period
- The SOA 2005 May Spring meeting (Session 6D) included results of a survey of regulators' views regarding "X" factor opinions
  - Appears not to be much concern by regulators regarding X factors
  - Few comments about the experience analysis methodology and data quality