

.....CPS BULLETIN.....

The Newsletter of CPS Actuaries and Computer Programming & Systems, Inc.

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Introduction

This is the first year anniversary issue of **CPS Bulletin**. We hope that you have found it interesting and informative. To see prior issues, visit our web site at www.cpsincorp.com. Articles in past issues cover topics ranging from Local Area Networks to the Gramm-Leach-Bliley Act to establishing a Web Site to proposed changes to the Actuarial Opinion and Memorandum Regulation.

Our first article in this issue is intended to alert you to the growing concerns that regulators have with small face amount policies. Most definitions of small face amounts include policies with face amounts of \$15,000 or less. The article outlines the benefits of small amount policies, the concerns of regulators and the different options being considered by regulators.

The second article gives a brief overview of Windows XP, which is the new Microsoft operating system that is due to be released by October. Our third article gives a broad overview of some of the more interesting items (in our opinion) included in the new tax law.

If you would like us to e-mail future issues of the newsletter to you, please let us know your e-mail address and we can arrange to make that happen. ❖

Small Face Amount Policies

Small face amount policies have been getting a lot of attention recently. Regulators are voicing concerns about how such policies are sold and priced as well as their overall economic value to consumers. The NAIC has established a working group that has held hearings on the issue. The working group has challenged insurers to provide solutions to the perceived problem, although it is not yet clear exactly what problems are to be solved.

Many industry leaders do not even feel that small face amount policies are a problem. There are a number of benefits to small policies, including the following:

- Expenses for a funeral and other final expenses can be managed efficiently through the purchase of a life insurance policy.
- The limited underwriting often used when issuing small policies provides coverage to a broad range of applicants.
- The policies are simple in design and easy to understand.
- The policies are affordable. While the rate per \$1,000 is often higher than it would be for a larger face amount policy, the annual premium outlay will be less than it would be for a larger policy.
- Purchasing a policy is a requirement in order to share in the other benefits (e.g., scholarships) offered by fraternal.

Whole life insurance will provide benefits in excess of the premiums collected for those individuals that die soon after purchasing a policy. On the other hand, by its very nature, whole life insurance will collect premiums in excess of the death benefit for those that survive a long time. The primary concern among regulators is the

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latter situation, especially when total premiums paid exceed the face amount by a large amount.

Other concerns of regulators when it comes to small face amount policies include the following:

- Are insurers offering volume discounts in the cases where one policyholder has multiple policies?
- What is the persistency experience on these policies?
- Does agent fraud occur when selling small face amount policies?

One other problem has also surfaced with regard to small face amount policies. While investigating surveys in connection with race-based underwriting, it was discovered that one large insurer failed to pay numerous legitimate death claims. This occurred because the policyholder had multiple policies but the claim was initially filed on only one of them and the insurer did not crosscheck for the other policies. Since this happened to one insurer, regulators are now concerned that it could be a problem at other companies.

One item that remains unclear is what size policy actually qualifies as a small face amount policy. It has been suggested that a small face amount policy would be any policy with a face amount of \$25,000 or less. However, regulatory attention has been focused on even smaller face amounts, with the most talked about cutoff appearing to be at \$15,000. It has been estimated that 75% of all fraternal policies have a face amount that is less than \$15,000, so any regulatory scrutiny in this area will certainly have an impact on fraternal.

Regulators appear to favor some sort of disclosure for addressing small face amount policies, although each state could develop its own requirements. Florida introduced a bill that would have required insurers to mail a notice annually to each Florida policyholder that has a life insurance policy with a death benefit of \$15,000 or less. The bill appears to have passed the Senate in Florida but died in the House, so it looks like it's a dead issue for now. Had it passed, the annual notice would have been required to show the following information:

- The total amount of premiums paid since the issue date of the policy,
- The cash value, and
- The amount of the death benefit.

This Florida bill also would have required life insurance policies issued beginning July 1, 2001 in Florida to increase the death benefit when total premiums paid exceeded a specified percentage of the death benefit. In particular, whenever the premiums paid were greater than 250% of the death benefit, the insurer would be required to increase the death benefit by \$0.50 for each additional premium dollar paid in excess of the 250% of the death benefit. For example, if a policy has a face amount of \$1,000 and the policyholder has paid in a total of \$3,000, then the death benefit would have to be increased by \$250.

Florida appears to be the only state that so far has considered making insurers change the benefits on small face amount policies. Other states appear to be looking into increasing disclosure requirements on these types of policies. New York, for example, requires wording similar to the following for certain policies with face amounts less than \$25,000:

"For insurance policies issued for small face amounts or with little or no underwriting, the premiums are often relatively expensive in relationship to the death benefit provided. For insurance purchases, as with any other type of purchases, it may be to your advantage to compare products and prices from a number of sources."

Some type of action on the small policy issue may occur at the summer meeting of the NAIC, at the earliest. The most likely outcome will probably mean more disclosure requirements. Fraternal will need to be aware of any new disclosure requirements that may impact the issuing of small face amount policies.❖

| Interest Rate Monitor | | | |
|---|---------|--------------|------------|
| The following are some key interest rate benchmarks: | | | |
| Benchmark | Current | 3 Months Ago | 1 Year Ago |
| Fed Funds | 3.94% | 5.00% | 6.50% |
| Prime Rate | 7.00% | 8.00% | 9.50% |
| 30 yr mortg | 6.78% | 6.58% | 7.87% |
| Source: www.bloomberg.com as of June 20, 2001. | | | |

XP: The New Operating System

In 1995, Microsoft introduced Windows 95, a new operating system, which is the software that makes a computer work. Windows 95 was the first personal computer operating system that enabled the computer to work simultaneously on more than one task. Since that time, Microsoft has launched several newer operating systems, including Windows 98, Windows 2000, Windows NT and Windows ME. Each version improved the earlier version, although sometimes the differences were not always very noticeable.

On October 25th, Microsoft expects to begin shipping Windows XP, which is yet another new operating system. XP stands for eXPerience. It will be the most significant upgrade of the PC operating system since Windows 95. XP should improve the stability of the PC by mitigating freezing, crashing and the ever-popular "blue screen of death" that often occur with current operating systems. Other new features include an Internet firewall, an integrated media player with CD-burning and DVD-playback features, moviemaking and photo-editing software, and Internet messaging (which will compete with AOL's Instant Messaging software).

When Windows 95 was released, PC makers saw a healthy influx in sales. Since more than 90% of desktop computers use Microsoft operating systems, many PC makers are relying on Windows XP to spur demand. Part of the reason PC sales are expected to increase is because Microsoft suggests that computers using Windows XP have 128 megabytes of RAM, and some market research indicates that less than 25% of all machines currently have that much RAM.

Microsoft has already released the XP version of its Office software, which includes 2002 versions of Outlook, Excel, Word, PowerPoint and Access. New computers are being shipped with the Windows ME operating system and the Office XP software.

One problem that Microsoft faced with prior versions of its Office software is that someone could buy the software and then install it (illegally) on multiple computers. To reduce this risk of piracy, Office XP will only allow you to install it twice. If you try and install it a third time, a message will appear that indicates the product was already activated on another machine and you must contact customer service (which has not

always been one of Microsoft's strong points). Microsoft promises, however, to make it easy to reinstall the software if, for example, your system crashes. Some analysts are suggesting that limiting the number of times the software can be installed will eventually lead to lower prices for people that actually buy, rather than borrow or pirate, software.

The following are some of the features that come with the new Office XP software:

- Permits you to save files to the Internet (using a free Microsoft portal). This will allow you to access those files from anywhere and make it easier to share the files with others. It also will free up disk space on your hard drive or LAN since the file will be stored elsewhere.
- Older versions of Office allowed you to copy and paste only one item at a time on to the clipboard. Office XP allows you to cut and copy up to 24 items on the clipboard.
- If you have a scanner, Office XP's Office Document Imaging can turn paper documents into digital text, which can be sent directly to Word.
- Outlook has improved virus protection to help prevent the spread of new viruses. The new Outlook will not let you open, run, copy, save or forward files attached to e-mails that have certain extensions (e.g., .exe, .bat, .hta and .pif).
- Office XP allows backward compatibility with older versions of Office. If you bring Office XP into your office in small stages (e.g., only new computers have it), it should not cause any problems. Thus, you'll still be able to open Word and Excel files created in XP in prior versions of Word and Excel.
- Office XP has voice recognition features that will enable a user to dictate text and have it appear as a Word document.

Do Office XP's capabilities outweigh its price, which is about \$225 for an upgrade and \$450 for new users (exclusive of the Windows XP operating system)? Early indications are that the upgrade is not worth the money if you just upgraded to Office 2000 within the past 2 years. However, Office 97 users might consider upgrading. The enhanced features should be weighed against learning the new software, the cost of the upgrade and the additional storage required on your hard drive. ❖

The New Tax Law Changes

Almost everyone has heard of the new tax law changes and the headline number of \$1.35 trillion being returned to US taxpayers. Rarely has a so-called tax simplification measure been so complex. This is because of the following reasons:

- These new tax rules will be phased in over 10 years. Incredibly, the new rules are due to expire after 2010 (or some time prior to that date) and revert back to current levels.
- The effect of the tax cut is very uneven over time since the bulk of the tax cuts come towards the end of the 10- year period and thus are susceptible to future legislative “tinkering”
- There was little modification of the Alternative Minimum Tax (AMT). It is estimated by some analysts that the number of taxpayers affected by the AMT will increase from a couple of million today to over 30 million in 10 years and thus as many as two-thirds of the tax breaks could be clawed back as a result.

Some of the highlights of the new Law are as follow:

- Across the board reductions in income-tax rates. There was about a 10% reduction in all income-tax rates (retroactive to January 1, 2001), with the top

rate dropping from 39.6% to 36%. A new 10% band was created at the lower end of the 15% bracket. This results in immediate refunds of \$600 for married taxpayers, \$300 for singles and \$500 for heads of household. Starting in July, refunds will be mailed to taxpayers that filed a 2000 return. The last 2 digits of your social security number will determine when your check will be mailed.

| Mailing Date | Last 2 Digits of Your SS# | Mailing Date | Last 2 Digits of Your SS# |
|--------------|---------------------------|--------------|---------------------------|
| July 20 | 00-09 | Aug 24 | 50-59 |
| July 27 | 10-19 | Aug 31 | 60-69 |
| Aug 3 | 20-29 | Sept 7 | 70-79 |
| Aug 10 | 30-39 | Sept 14 | 80-89 |
| Aug 17 | 40-49 | Sept 21 | 90-99 |

- Boosts for retirement savings. Contributions to IRA's will increase to \$3,000 in 2002 and to \$5,000 in 2008. Special provisions enable workers 50 years of age or older to make larger “catch-up” contributions. Maximum contributions to 401(k) plans will increase from \$11,000 in 2001 to \$15,000 in 2005. Higher limits will also apply to 403(b), 457 and SIMPLE plans.
- Tax breaks for education. State-sponsored prepaid tuition plans will be completely tax-free in 2002, and these plans will be extended to private colleges beginning in 2004. Other provisions include (a) a college tax deduction as an alternative to the Hope Credit or Lifetime Learning Credit, (b) an increase in the tax deductibility of student loans, and (c) an increase in the educational IRA limit from \$500 to \$2,000.
- Marriage penalty relief. The standard deduction for married couples will eventually increase to twice the single person's deduction, although the phase in period is 2005 to 2010.
- Tax breaks for families. The child tax credit will increase from \$600 in 2001 to \$1,000 by 2010. The dependent care credit will be increased from \$2,400 to \$3,000 in 2002.
- Repeal of estate taxes. The estate tax exemption will gradually increase from \$675,000 to \$3.5 million in 2009. Estate taxes will be abolished in 2010. However, since the tax rules expire in 2011, in theory, the estate tax will then resurface. ❖

About CPS

CPS Actuaries and Computer Programming & Systems, Inc.

CPS is an independent company with over 30 years of service to our clients. We offer a wide range of computer and actuarial services.

There are two major divisions that make up CPS. One is an actuarial consulting firm that specializes in the needs of fraternal benefit societies. The other is a computer consulting firm that primarily manages computer networks as an outside consultant for a variety of companies, and develops, hosts and maintains e-mail and web sites. For further information regarding our services, contact us at 203-324-9203, or visit our web site at www.cpsincorp.com. ❖

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