

....CPS BULLETIN....

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Introduction

In this issue of **CPS Bulletin**, we have a new abbreviation for everyone to learn. It is ROP, which stands for Return of Premium. ROP term insurance is developing a following in the insurance industry and our lead article in this newsletter covers the issues regarding such a plan.

Our second article covers a topic that's becoming more and more popular on the Internet called blogs. These blogs recently came to light when they were credited with doing some research to discredit a news story that aired on the news magazine "60 Minutes". The article provides an overview of what blogs are and how they are exploding on the Internet scene.

In the Regulatory Update section, we have a status update regarding the USA Patriot Act and a new annual filing requirement for the state of NY which applies to all insurers licensed in the state.

We hope that you enjoy receiving this newsletter. If you have any comments or suggestions on how we can improve **CPS Bulletin**, please contact us by visiting our company web site at www.cpsincorp.com. Past issues of the newsletter can also be found at our web site.❖

Are ROPs Right for You

All of a sudden Return of Premium (ROP) policies are hot. Why? Well, partly because there is not much else new in the life insurance market and partly because they do have some positive aspects.

What are ROPs?

As its name implies, ROP policies promise to return all of the premiums paid to the insured if he survives to the end of a particular period. ROPs are typically level term policies with a rider attached. The rider sets forth the amount of premiums that will be returned to the insured if he or she survives to the end of the level term period (which is either 10, 15, 20 or 30 years). Interest is not paid on the premiums (e.g., if you pay \$1,000 a year for 20 years then you get back \$20,000). In the event of lapse during the level term period, most ROP plans provide for the payment of some percentage (which is less than 100%) of the total premiums paid at the time of lapse.

Premiums for a ROP policy are greater than they would be for a term policy without the ROP benefit, but the premiums are much less than for other permanent plans of insurance with cash value build-up, such as whole life and universal life.

Are there regulatory issues involving ROPs?

When ROPs were first introduced, some insurers did not provide for any return of premiums until the end of the level term period. However, most insurance departments are now requiring some return of premium prior to the end of the level period in order to comply with the non-forfeiture laws. But the requirements vary by state. In fact, according to our latest information, certain states, including NY, WA and UT, do not allow ROPs.

What are the advantages to the insured?

One of the biggest complaints among people that purchase term insurance is that if they survive until the

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end of the term period then they get nothing back in return. The ROP policies eliminate this complaint. If the insured survives to the end of the term period, then the insured will have something to show for the money paid all those years.

Other advantages to ROP policies are the following:

- ROPs are less expensive than permanent life plans, such as whole life and universal life.
- It is easy for the agent to explain the benefits to the insured. Many individuals have a hard time understanding the cash value build-up of a whole life policy. Everyone can understand the concept of "return of premiums".
- If you factor in that the insured is getting life insurance coverage and a return of premiums, some ROP plans can give good returns. This is because ROPs are lapse-supported, which means that the policies that lapse prior to the end of the term period support those that endure to the end. Some companies selling ROPs advertise returns as high as 14% per annum.

Are there disadvantages for the insured?

- ROP is not as cheap as pure term insurance. If it is death protection that the insured is seeking, then he can get significantly more coverage for the same ROP premium outlay by choosing term insurance without ROP.
- The ROP life coverage expires (or becomes significantly more expensive) at the end of the level term period, at which time the insured may no longer be insurable at the best rates.
- If the insured terminates coverage prior to the end of the level term period, the cost of the insurance can be expensive.

How can ROPs affect an insurer?

The ROP plan has a number of advantages for an insurer. First, since ROP plans have larger premiums than term plans without the ROP, the insurer will have a larger cash inflow with the same mortality risk and sales effort. Second, ROP plans have a cash value build-up (unlike pure term policies) and therefore a larger reserve, which can partially offset the loss from operations if an insured does die prior to the end of the term period. Third, there are only a few insurers that currently write ROPs so if you do enter this market then

your product may stand out. And fourth, ROPs also obviate the objection sometimes raised to small face amount policies where the insured is getting less in benefits than he has paid in premiums. In the case of ROPs, the insured can get back all of his premiums and not pay in more than his face amount.

There are some risks to the insurer. First, if the premiums are lapse supported then there is an unreinsurable persistency risk. Second, the reserves required for ROP plans are significantly larger than for term plans. Reserves are the greater of the XXX Model Regulation reserve and the present value of the ROP endowment. Since the present value of the endowment assumes no lapses, the reserve will cause a strain on operations if lapses are built into the premium rates. Third, ROP plans will typically cost the insurer more than a pure term policy since there are additional expenses to develop and administer the plan and the work involved in order to obtain approval from the various insurance departments. Finally, ROP plans are vulnerable to a low interest rate environment if the rate assumed in pricing cannot be achieved.

What are sample premium costs for ROPs?

A web site to do a comparison of ROP rates can be found at terminsurance4less.com. The ROP rates are typically 50% to 100% more than the rates for a pure term insurance policy.

Do ROPs make sense for your fraternal?

According to LIMRA, the market focus for ROPs are individuals between ages 35 and 45 with income in the \$50,000 to \$100,000 range. You may wish to consider developing an ROP rider if your society (a) already writes term insurance, (b) has the ability to underwrite policies with face amounts larger than \$25,000, and (c) has appropriate sales people in place. You may find that adding a ROP rider may assist you in writing higher face amounts, which will help to reduce your per policy expenses and bring in additional premium income.

On the other hand, fraternal that do not already have a term plan in place and cannot write policies with face amounts greater than \$25,000 (either because the surplus isn't large enough or because there aren't the appropriate reinsurance agreements in place), then the ROP rider may not be for you. ❖

What the Heck is a Blog?

You may recall that recently objects called *blogs* played a part in mobilizing a denunciation of Dan Rather's story on CBS regarding President Bush's service in the Texas National Guard. That got us to thinking: What are blogs and how can the average person use them?

A blog, which is short for web log, is basically an easy-to-use web site where the author can quickly post thoughts and interact with others. Blogs are often online diaries that serve as a personal journal for the author. They are updated day by day with new information about a particular subject or range of subjects and is intended for general public consumption. Blogs generally represent the personality of the author or reflect the purpose of the web site that hosts the blog. Topics sometimes include brief philosophical musings, commentary on Internet and other social issues, and links to other sites the author favors. The entries can often be mundane, ranging from the author's favorite recipes to information about his love life. The essential characteristics of the blog are its journal form, typically a new entry each day, and its informal style. The author of a blog is often referred to as a blogger.

Blogs seem popular because the viewer knows that something changes every day, there is a personal, rather than bland commercial point-of-view and, on some sites, there is an opportunity to collaborate or respond with the web site and its participants. Currently, the most popular and best blogs are the ones that comment on the news of the day. These blogs give intelligent commentary on the news and are often accompanied by links to the news articles in question.

One can use a blog to communicate efficiently with large or dispersed groups of people. For example, blogs are sometimes used to communicate with a college class or to serve as a private family journal or to provide an ongoing record of a planned wedding. One blog that was only a single page web site took the Internet by storm back in 1999. It was the homepage for an obscure Turk named Mahir Cagri. He set up a homepage seeking a female companion featuring pictures of him playing ping pong and lounging around in tight fitting swimming trunks. The site quickly

became a cult hit on the net, with millions of hits and a series of tribute sites. Mahir himself has become an Internet icon and has secured a place in the Guinness Book of World Records for the most hits to a homepage.

Blogs are not created just by individuals. They can also be used by the author to link together different news stories from different sources. For example, one such blog is ESPN.com's NFL blog, which provides updated information about the NFL. Another site is cookingforengineers.com, which offers different recipes and deals on certain products like steak knives. The site's motto is: "Have an analytical mind? Like to cook? This is the site to read!"

If anyone can create a blog, you're probably wondering why anyone would want to waste time reading through some amateur's comments about a particular subject. Well, the answer is that while there is a lot of garbage on the Internet, the worst blogs sink to the bottom because nobody reads them. And in fact most blogs are worthless. However, the best blogs rise to the top due to the large volume of bloggers that link to them. As more and more sites link to a particular blog, then the higher it appears on the list when Google does a search for that particular topic.

Although similar, blogs are not to be confused with message boards. While both are easily updatable web sites that allow messages to be viewed by others, the key difference is that the blog only allows the author to post messages. Visitors can view the information in a blog but they cannot post to it. The visitors can provide messages to the administrator, who then decides whether or not to post the messages to the site.

Although a blog is essentially a personal web site, it has a few advantages over a typical, standard web site. Web sites are usually a chore to update regularly, so few people even bother. However, updating a blog is as easy as sending an e-mail. All you need is the time and the right software to update your blog daily or even hourly.

So how did the bloggers catch Dan Rather? To quickly recap, *60 Minutes* ran a news story on September 8th indicating that they had documents about President Bush's service in the National Guard. In that story, they published a never-before-seen memorandum from

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1972. In that story, CBS indicated that they had consulted with a handwriting expert and a document expert who believed the material was authentic. CBS posted the documents to their web site for everyone to view. And then the bloggers went to work reviewing and sharing insights about those documents.

On September 9th, a day after the story aired, the bloggers had discovered things wrong with the documents. Their first clue was the font that was used appeared to be Times New Roman; since the document was supposedly typed on a typewriter in 1972, it was impossible for the typewriter to have used that font. Other clues also came to light due to the research by the bloggers and *60 Minutes* later admitted to the fact that the documents were not authentic.

If you are interested in visiting some of the more popular blogs, one web site to visit would be bloglines.com. It's billed as "the most comprehensive, integrated service for searching, subscribing, publishing and sharing news feeds, blogs and rich web content." Best of all, it's free and easy-to-use. ❖

About CPS

CPS Actuaries and Computer Programming & Systems, Inc.

CPS is an independent company with over 35 years of client service. We offer a wide range of computer and actuarial services, including the following:

- Actuarial valuations
- Annual and quarterly statement preparation
- Policy administration software
- NAIC compliant illustration software
- Web site hosting, instant messaging and e-mail
- Design, install and maintain local and wide area networks
- Hardware & software installation and upgrades

For more information regarding our services, please call us at **203-324-9203**, or visit our web site at www.cpsincorp.com ❖

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Regulatory Update

The Patriot Act

In our October 2002 newsletter we outlined the principal provisions of the Patriot Act relevant to Fraternal. These provisions, particularly the anti-money laundering provisions and the requirements to have a compliance officer in place, are still in force. However, the Act has been in the news recently owing to strong opposition being mounted (with some success) to get some of its provisions declared unconstitutional.

Also, Congress wrote sunsets into the Act for some of the most controversial sections including powers to conduct searches (including searches of financial records) without notifying the subject of the search. The sunsets mean that 17 key provisions of the law, primarily those which extend the surveillance powers of the federal government, will expire in December of 2005 if no new legislation is passed by both houses of Congress and signed by the president.

New York Circular Letter Number 7 (2004)

In August of 2004 the NY Insurance Department updated circular letter No. 11 (2001). The circular letter applies to all NY insurers including fraternal benefit societies. It asked for a description of the insurer's Disaster Response Plan (DRP). A DRP is intended to show that the insurer has the resources in place in order to recover from a disaster. A DRP must also include a review of the Board of Directors arrangements for an "Emergency Preparedness Plan".

A reply was required by October 5, 2004. However, DRPs should be updated annually on June 1st. If no update is necessary, an e-mail must be submitted to the NY Department's Disaster Plans mail box (drp@ins.state.ny.us) indicating no change to the plan. ❖

Interest Rate Monitor

The following are some key interest rate benchmarks:

<i>Benchmark</i>	<i>Current</i>	<i>3 Months Ago</i>	<i>1 Year Ago</i>
Fed Funds	1.75%	1.25%	1.00%
Prime Rate	4.75%	4.25%	4.00%
30 yr mortg	5.42%	5.83%	5.37%

Source: www.bloomberg.com as of October 4, 2004.