On August 9, 2011, SCOR SE, a global reinsurer with offices in more than 31 countries, acquired substantially all of the life reinsurance business, operations and staff of Transamerica Reinsurance, the life reinsurance division of the AEGON companies. The business of Transamerica Reinsurance will now be conducted through the SCOR Global Life companies, and Transamerica Reinsurance is no longer affiliated with the AEGON companies.

While articles, treaties and some historic materials may continue to bear the name Transamerica, AEGON is no longer producing new reinsurance business.

Archive Materials

Term Conversions – Balancing Value, Price and Risk
Reprinted from the June 2011 Messenger newsletter

By Brian Traxler, ASA, MAAA Second Vice President and Marketing Actuary

While almost every term carrier offers term-to-perm conversion provisions, individual company strategies drive what is provided in these provisions. Some companies (particularly mutuals) use term as a “foot in the door” to gain clients, selling less expensive term products to young families and then encouraging (and expecting) those consumers to convert to permanent products later. Pricing and producer compensation often reflect this high conversion expectation.

Some companies view conversions as part of their customer retention strategy. The conversion option is priced into the term products as opposed to increased rates on the perm products.

Other companies may offer conversion provisions hoping policyholders don’t exercise them. The provisions are offered only because competitive forces in the market dictate them. In such circumstances, factoring conversion options into term pricing has not been a priority. In any case replacement historically has been a more attractive choice than conversion due to continually dropping rates.

Regardless of strategy, provisions under conversion riders traditionally have been generous, offering long option exercise periods, a menu of permanent products with guaranteed rates, and no re-underwriting.

A Changing Environment

As the market has changed, two major factors have added to the economic value of these conversion options. Recent economic conditions have led consumers and their producers to find ways to maximize value in all existing products. This was perhaps most visible in the financial crisis’s effect on

<table>
<thead>
<tr>
<th>Company</th>
<th>Term Experience</th>
<th>Converted Policy Experience</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>48.4%</td>
<td>69.2%</td>
<td>143.0%</td>
</tr>
<tr>
<td>B</td>
<td>46.0%</td>
<td>81.6%</td>
<td>177.4%</td>
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<tr>
<td>C</td>
<td>66.3%</td>
<td>83.1%</td>
<td>125.3%</td>
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<tr>
<td>D</td>
<td>59.9%</td>
<td>114.0%</td>
<td>190.4%</td>
</tr>
<tr>
<td>E</td>
<td>57.9%</td>
<td>45.5%</td>
<td>78.6%</td>
</tr>
</tbody>
</table>

* Issue Years: 1995+; Companies with at least 50 conversion claims

Figure 1: Mortality Experience, Post-Conversion*
variable annuity living benefits.

Equally important, a pricing “truce” has developed in the term wars. Rates that had been on a steep downward trajectory have flattened out. Replacement for term products reaching the end-of-level-premium period has become much less attractive than it had been in the past, especially for those with impaired health.

The underwriting-free nature of conversion provisions also has become increasingly popular. This naturally attracts more adverse risks as the end-of-level-premium period approaches. And the advent of life settlements may exacerbate post-conversion lapse and mortality issues. Figure 1 illustrates that in many cases the mortality experience on converted policies is much greater than the term experience and varies greatly between companies.

**Company Responses**

Of course, if pricing reflects the anticipated selection issues then many of these products may need only minor adjustments to ensure continued profitability. But when the economic value of a benefit exceeds the cost charged, companies have two options: raise rates or reduce benefits. In a price-elastic market such as the term life market, any substantial rate increase can effectively price a firm out of the market. This means that the primary course of action is to adjust provision guidelines.

As a result, we have seen a number of carriers introduce substitute convertible term products. While each product’s provisions may vary either in features or in magnitude of change, we see several common approaches:

*Closing the Window.* Companies formerly had allowed conversions to take place up to and beyond the end-of-level period. Many companies have shortened this period, requiring conversions, for example, only up to Duration 10. Some companies (particularly mutuals) have pushed the timing even earlier in the policy’s lifetime. Earlier periods aid in both mortality and financial risk selection.

*Limiting Perm Product Options.* New convertible term products may have more limited options on the types of products to which a policyowner may convert. A few of these new permanent products have higher rates to reflect the expected post-conversion mortality. Others have modified the products from level premiums to term-limited guaranteed rates. This change in rate structure may be seen as particularly helpful in dissuading life settlement firms.

*Decrease Producer Incentives.* Many carriers have special commission provisions now for converted policies, including lower renewal commissions (though some companies argue that this is counterbalanced by the higher premiums). Additionally, converted policies may be exempt from bonus or other sales incentive campaigns.

Regardless of conversion strategy, companies that offer the provision will have at least some customers who will choose to switch to permanent coverage. Consequently, they should either factor the higher expected mortality into their pricing and/or try to lessen the anti-selection by controlling the breadth of conversion options. It should be noted that companies replacing their traditional term products with term-on-UL policies have addressed some of the conversion issues discussed above.