United States General Accounting Office

GAO

Fact Sheet for the Honorable Fortney H. (Pete) Stark, House of Representatives

August 1988

TAX POLICY

Additional Information on Life Insurance Mortality Charges

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GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-229198

August 8, 1988

The Honorable Fortney H. (Pete) Stark
House of Representatives

Dear Mr. Stark:

On July 12, 1988, you requested that we provide additional information on the single premium life policies discussed in our earlier report entitled TAX POLICY: Mortality Charges on Single Premium Life Insurance Should Be Restricted (GAO/GGD-88-95, June 14, 1988). In particular, you asked that we determine (1) whether the 40 policies examined in our report were filed with the District of Columbia before or after the District passed a law to prohibit insurers from discriminating because of Acquired Immune Deficiency Syndrome (AIDS) and (2) if similar policies were filed in a jurisdiction that does not have an AIDS anti-discrimination insurance law.

RESULTS IN BRIEF

Of the 40 policies included in our sample from the District of Columbia, over 40 percent were filed before the District's AIDS anti-discrimination law was enacted. The same 40 policies were filed in the State of Maryland, which does not have an AIDS anti-discrimination law. With one exception, the mortality charges specified in the policies filed in Maryland were the same as those specified in the policies filed in the District of Columbia.

BACKGROUND

In our June 1988 report, we discussed how section 7702 of the Internal Revenue Code gives life insurance companies the option of increasing a policy's mortality charges in excess of those normally considered reasonable for a life insurance contract. We said that higher mortality charges can be used to provide insurance to individuals who are considered substandard risks. However, higher mortality charges can also be used to inflate premiums for individuals normally considered standard risks. On investment-oriented products like single premium life insurance, policyholders, by paying higher premiums, are able to shelter more money for investment. Thus, more funds are available for low-cost, tax-free policy loans. We concluded that any proposal to eliminate the tax advantages of single premium life insurance should be one designed to limit the tax advantages associated with using mortality charges to enhance the investment attributes of a life insurance contract.

As part of the proposed Miscellaneous Revenue Act of 1988 (H.R. 4333, July 15, 1988), the House Committee on Ways and Means adopted language that would change the law to limit the ability of life insurers to specify unreasonable mortality charges in a life insurance policy. We understand that, during deliberations on the bill, representatives of the life insurance industry questioned the extent to which companies specify higher mortality charges because the 40 contracts we examined were obtained from the District of Columbia. They asserted that mortality rates in the policies submitted to the District of Columbia would be higher than those in other jurisdictions because companies that issue policies in the District could experience higher mortality due to the District's enactment of the Prohibition of Discrimination in the Provision of Insurance Act of 1986. The act, which was passed on June 6, 1986, and effective on July 6, 1986, prohibits life insurers from discriminating or adjusting insurance rates on the basis of any test to screen for the probable causative agent of AIDS; AIDS Related Complex (ARC); or Human T-lymphotropic virus, type-III (HTLV-III) infection.

OBJECTIVES, SCOPE, AND METHODOLOGY

To determine whether the 40 policies we examined in our report were filed with the District of Columbia before or after the District's AIDS anti-discrimination law was enacted, we compared the date each policy was filed with the date the law was passed. All 40 policies were filed with the District of Columbia during the 5-year period ending June 1987. To determine whether similar policies were filed in another jurisdiction that does not have an AIDS anti-discrimination law pertaining to insurance, we examined the same 40 single premium policies as filed both with the District of Columbia and the Insurance Division of the Department of Licensing and Regulation for the State of Maryland. We chose Maryland because it has not enacted a law that prohibits insurers from discriminating because of AIDS, ARC, or the HTLV-III infection.

Our review was done during July 1988 in accordance with generally accepted government auditing standards.

ANALYSIS OF THE DATES POLICIES WERE FILED IN THE DISTRICT OF COLUMBIA

Table 1 illustrates the distribution of the policies by mortality assumption and indicates whether the 40 policies were filed with the District of Columbia before or after the date the AIDS anti-discrimination law was enacted. As the table shows, 17 of the 40 policies (42.5 percent) were filed with the District before the law was enacted. Two of the policies submitted before enactment of the law had maximum mortality charges in excess of 10 times standard mortality; none of the 23 policies filed after the law was enacted were in that category.

Table 1:
Maximum Mortality Charges
Specified in 40 Single Premium Life Contracts
Filed With the District of Columbia

Multiple[a]	Contracts filed before the AIDS anti-discrimination law (6/6/86)		Contracts filed after the AIDS anti-discrimination law (6/6/86)		Total contracts	
	Number	Percent	Number	Percent	Number	Percent
Less than 1.0	1	50	1	50	2	100
1.0[b]	8	57	6	43	14	100
1.01 to 1.99	6	38	10	62	16	100
2.0 to 2.9	0	0	5	100	5	100
6.0	0	0	1	100	1	100
10.0 and above	2	100	0	0	2	100
Total	17	42.5	23	57.5	40	100

[a]A multiple of one (1.0) refers to standard mortality as derived from either the 1980 or the 1958 Commissioners Standard Ordinary tables. In some contracts that multiple can be higher or lower depending on the age of the insured. For example, the two policies that state a maximum mortality charge of 10 and above (10.71 and 11.27) had a decreasing multiple each year after age 35. By age 85, the multiple decreased to 3.16 and 2.9 respectively.

[b]Includes eight policies that did not specify a maximum mortality charge.

Source: Data used in the preparation of this table was obtained from single premium policies filed with the Insurance Administration for the District of Columbia.

ANALYSIS OF MORTALITY CHARGES IN MARYLAND POLICIES

We found that the 40 policies filed with the District of Columbia were also filed with the State of Maryland and that 39 of the 40 included the same mortality assumptions. The remaining policy had a maximum mortality charge that was slightly lower in the District of Columbia (1.18 times the standard mortality charge as compared to 1.23 times the standard mortality charge). In both jurisdictions, 60 percent of the policies specified mortality charges that were higher than the standard mortality charge. Table 2 compares the number and percent of policies by mortality assumption for these jurisdictions.

Table 2:
Comparison of Maximum Mortality Charges in 40 Single Premium Contracts Filed Both With the District of Columbia and the State of Maryland

Multiple[a]	Number of contracts filed with the District of Columbia		Number of contracts filed with the State of Maryland	
	Number	Percent	Number	Percent
Less than 1.0	2	5	2	5
1.0[b]	14	35	14	35
1.01 to 1.99[c]	16	40	16	40
2.0 to 2.9	5	12.5	5	12.5
6.0	1	2.5	1	2.5
10.0 & above	2	5	2	5
Total	40	100	40	100

[a]A multiple of one (1.0) refers to standard mortality as derived from either the 1980 or the 1958 Commissioners Standard Ordinary tables. In some contracts that multiple can be higher or lower depending on the age of the insured. For example, the two policies that state a maximum mortality charge of 10 and above (10.71 and 11.27) had a decreasing multiple each year after age 35. By age 85, the multiple decreased to 3.16 and 2.9 respectively.

[b]Includes eight policies that did not specify a maximum mortality charge.

[c]This category includes one policy where the mortality charge was slightly lower in the District of Columbia (1.18 times standard mortality as compared to 1.23 times standard).

Source: Data used in the preparation of this table was obtained from single premium policies filed with the Insurance Administration for the District of Columbia and the Insurance Division of the Department of Licensing and Regulation for the State of Maryland.

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We hope you find this information useful in your deliberations on life insurance mortality charges. As agreed with your office, we will make this information available to other interested parties upon request. If you or your staff have questions, please contact Mr. Natwar Gandhi of my staff on (202) 272-7904.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Associate Director

(268370)

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