STATE OF OHIO
DEPARTMENT OF INSURANCE
2100 Stella Court
Columbus, Ohio 43215

IN THE MATTER OF	:	**CONSENT ORDER**
THE WESTERN AND SOUTHERN LIFE	:	
INSURANCE COMPANY	:	
MARKET CONDUCT EXAMINATION	:	

The Superintendent of the Ohio Department of Insurance ("Department") is responsible for administering Ohio insurance laws pursuant to Section 3901.011 of the Ohio Revised Code ("R.C."). The Western and Southern Life Insurance Company ("Company") is domiciled in the state of Ohio, is authorized to engage in the business of insurance in the state of Ohio; and, as such, is under the jurisdiction of the Superintendent and the Department. On June 12, 2000, as part of a national review, the National Association of Insurance Commissioners ("NAIC") adopted a resolution, in which the members of the NAIC agreed to work cooperatively, to determine if individual insurance companies had engaged in race-based discriminatory practices, and to jointly seek a multi-state settlement with each of the affected insurance companies. Pursuant to this resolution, the Superintendent, as primary examiner and negotiator, and in consultation with regulators in Illinois, Indiana, Michigan, and North Carolina, conducted a market conduct examination of the Company related to the sale of industrial life and certain other life insurance policies. As a result of this examination, the Superintendent has entered into this Consent Order with the Company.

SECTION I

A. On June 14, 2001, the Department began a targeted, multi-state market conduct examination to investigate possible race-based underwriting practices of the Company. For the purposes of the market conduct examination and this Consent Order, the look-back period utilized was 1889, which was the effective date of the analogous statues preceding R.C. Sections 3911.16 and 3911.17.

B. Beginning in 1957 and continuing through 1970, the Company acquired eight life insurance companies, including companies that may have engaged in race-based underwriting practices prior to their acquisition by the Company.

C. In 1988, the Company voluntarily implemented an extensive internal program to identify those industrial and ordinary policies in force that may have been priced on a racially distinct basis and that were still in force on a premium-paying basis. The Company then provided an increased amount of insurance protection to these policyholders. In 2000 and 2001, the Company enhanced all then in force industrial and ordinary policies issued with premiums that may have been determined on a racially distinct basis that had not been enhanced in 1988. In 2005, the Company made additional enhancements to in force policies that were recommended by Actuarial Resources Corporation ("ARC"), the Department's consultants in the examination.

D. At all times herein, the Company fully cooperated in the investigation, giving full access to its personnel, records, facilities and results of its own internal examination of documents. The Department satisfied itself that the Company made its best efforts to identify any policies with potentially race based premiums.

E. As a result of this market conduct examination, the Superintendent alleges that until 1966, companies that were later acquired by the Company (and the Company itself for a period of less than a year in the 1950s) sometimes used race as a factor in underwriting, which led to some African-American applicants paying higher premiums than some Caucasian applicants. The Superintendent acknowledges that the Company's practices at issue did not constitute intentional or willful violations.

F. The Superintendent further alleges that the above-described business practice constitutes a violation of R.C. 3911.16, 3911.17, 3901.20 and 3901.21.

SECTION II

It is hereby agreed to and consented by the parties that:

A. The Superintendent and the Company enter into this Consent Order to resolve the allegations as set forth in Section I of this order. In doing so, the Company expressly denies any wrongdoing alleged by the Superintendent and does not admit or concede actual or potential fault, wrongdoing or liability in connection with any facts or claims that have been or could have been alleged against it by the Superintendent.

B. The Company has been advised that it has a right to a hearing before the Superintendent pursuant to R.C. Chapter 119; that, at a hearing, it would be entitled to appear in person, to be represented by an attorney or other representative who is permitted to practice before the agency; and that, at a hearing, it would be entitled to present its position, arguments or contentions in writing and to present evidence and examine witnesses appearing for and against it. The company hereby waives all such rights.

C. The Company consents to the jurisdiction of the Superintendent and the Department, as primary examiner and negotiator on behalf of the regulators of the various other states where the Company transacts the business of insurance, to determine the issues set forth herein. The Company expressly waives any prerequisites to jurisdiction that may exist.

D. The Company shall complete its adjustment effort as described herein and shall not make or permit any unfair discrimination between individuals of the same class and hazard by reason of race.

E. The Company agrees to develop a policyholder notification program to assist it in locating persons eligible for any of the settlement benefits as outlined herein. Within 120 days of the execution of this Consent Order, the Company shall submit this policyholder notification program to the Department for approval. A notification program is required because the policies involved have not been offered for a substantial number of years, they were offered primarily by entities before those entities were acquired by the Company, the older historical files contain incomplete

information, and there is a lack of consistent and well documented relationships between plan codes used in rate books and those contained on the Company's administrative systems.

The program will include a process whereby written notice of the settlement will be sent to the last known address of record to all policyholders and beneficiaries eligible for benefits under this settlement whose policies have terminated. In order to locate those individuals who are no longer at the address of record maintained by the Company, the Company shall develop and implement an internal locator plan satisfactory to the Department. The Company will also issue a public notice, in a form approved by the Department, notifying former policyholders and their descendents of their right to benefits under this settlement. Notice shall be published in publications approved by the Department.

F. The Company agrees to pay a regulatory enhancement of twenty-five dollars ($25.00) per policy to holders of policies remediated as set forth in Section IIG. below, or their beneficiaries if the policyholder cannot be paid, who make a valid claim under the terms of this Consent Order. This regulatory enhancement will be paid on in force policies by increasing the benefits of those policies by the amount of the regulatory enhancement.

G. Scope of Remediation

1. In force policies. The Department acknowledges that based on its examination, including the report of ARC, that all eligible policies in force on February 24, 2005 have been fully remediated.

2. Terminated policies on which there was a previous payment (death claim, maturity or cash surrender). For a period of one year from the implementation date of this Consent Order, the Company shall honor all claims shown to be valid by the claimant by providing additional benefits with respect to the policies not in force on February 24, 2005 on which the claim has been made to ensure that Caucasian and African-American policyholders are treated the same and in accordance with ARC's report.

H. In addition to the regulatory enhancement and remediation terms contained herein, the Company agrees to a minimum benefit floor of $2,000,000.00, which has been adjusted to reflect the enhancement payments made prior to 2005 by the Company. This floor amount will be reduced by benefits and payments made under paragraphs F and G. After one year from the implementation date of this Consent Order, if a minimum benefit amount of $2,000,000.00 has not been reached, the Company agrees to meet and confer with the Superintendent to determine appropriate disposition of part or of all of the remainder. The Company agrees that ultimately any unused funds from the minimum benefit floor shall be donated to one or more educational institutions or charities that serve African-American causes or interests.

I. The Company will make an administrative payment in the amount of $400,000.00 to be split among the various participating states. The participating states will have ninety days after the date of execution of this Consent Order, or such longer period if the Superintendent determines it is appropriate, to join this global settlement. The

number of participating states and their respective pro-rata share of the total affected in-force policies will determine the final allocation. Each eligible and participating state will receive a minimum of $1,000.00. This payment shall be in lieu of any other administrative penalty that may be imposed by the Superintendent.

J. The Company has paid $7,406.00 in administrative costs directly incurred by the Department to perform the Market Conduct examination. In addition, the Company has paid $182,111.94 in administrative costs directly incurred by ARC to perform the Market Conduct examination. ARC and the Department will invoice the Company for any additional administrative costs.

K. The Company waives any and all causes of action, claims or rights, known or unknown, which it may have against the Department, and any employees, agents, consultants, contractors or officials of the Department, in their individual and official capacities, as a result of any acts or omissions on the part of such persons or firms arising out of this matter.

L. The Company has read and understands this Consent Order. The Company further understands that it has the right to seek counsel of its choice and to have counsel review this Consent Order.

M. This Consent Order has the full force and effect of an Order of the Superintendent. Failure to abide by the terms of this agreement shall constitute an actionable violation in and of itself without further proof and may subject the Company to any and all remedies available to the Superintendent.

N. This Consent Order shall be entered in the Journal of the Ohio Department of Insurance. All parties understand and acknowledge that this Consent Order is a public document pursuant to R.C. 149.43. Neither this Consent Order, nor the negotiations leading thereto, nor the fact of its having been made, shall be admissible or entered into evidence for any purpose whatsoever, except with regard to any effort by the Superintendent or the Company to enforce or interpret the terms of the Consent Order.

Date: 8-12-05

Carroll R. Hutchinson, Sr. Vice President
The Western and Southern Life Insurance Company

Date: 8-12-05

Donald J. Wuebbling, Sr. Vice President
The Western and Southern Life Insurance Company

Date: 8/24/05

Ann H. Womer Benjamin
Superintendent of Insurance
Ohio Department of Insurance

ACTUARIAL REPORT

RACE BASED PRICING ACTIVITIES
WITH RESPECT TO THE LIFE INSURANCE
BUSINESS OF WESTERN & SOUTHERN LIFE
INSURANCE COMPANY

December 31, 2003

Prepared by:
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December 31, 2003

Mr. Dan Atkisson
Ohio Department of Insurance
Market Conduct Division
2100 Stella Court
Columbus, OH 43215-1067

Re: Western & Southern Life Insurance Company (WSLIC) Race Based Pricing Examination

Dear Mr. Atkisson:

Enclosed you will find our final report on the race based pricing activities of WSLIC. Copies of this report should be distributed only in their entirety and after notifying us in advance.

Let me know if you have any questions regarding the contents of the report.

Sincerely,

John A. MacBain, FSA, MAAA
Vice President, Actuarial Resources Corporation

Introduction

The Ohio Department of Insurance (ODI) has requested Actuarial Resources Corporation of Georgia ("the examiners") to perform a special multi-state market conduct examination of the premium structures applicable to and the underwriting procedures utilized with regard to the life insurance business of Western and Southern Life Insurance Company (WSLIC or "the company"). Such business ("reinsured business") includes any life insurance business acquired from another company as part of an assumption reinsurance agreement or as part of the acquisition of the company itself. The purpose of this special exam is to determine whether, and to what extent, the premium structures of the life insurance business in question contain or contained variations which, in fact or in effect, reflect differentials based on the race of the insured. This exam has been performed in accordance with any guidelines and principles established for such exams by the NAIC Race Based Premium Working Group. Pursuant to those guidelines and principles, the exam was a multi-state exam conducted on behalf of all states but with particular coordination between the ODI and WSLIC's other top four policy count (year end 2000) states of Indiana, North Carolina, Illinois and Michigan.

The request of the ODI to perform a special market conduct examination in this area arose pursuant to concerns raised by the National Association of Insurance Commissioners (NAIC) that premium differentials in life insurance rates based on the race of the insured (in particular, African-Americans) existed and/or continue to exist in the marketplace. The concerns expressed were mainly with regard to blocks of business which had been issued many years in the past but also involved the desire to determine whether the practice of varying life insurance premiums by

race continues to the present. Pursuant to the NAIC's concerns, in 2000 the ODI initiated a questionnaire directed to all domestic companies to determine which, if any, were or are involved in the marketing of life insurance on a racially distinct premium basis. A similar questionnaire had been propounded by several state insurance departments in 1988 (a copy of WSLIC's response to this survey is attached as Attachment 1). Based on the results of the ODI questionnaire promulgated in 2000, as it applied to WSLIC's direct business and its reinsured business, a special market conduct exam which is the subject of this report was commissioned.

Overview and Scope of Project

The response of WSLIC to the 2000 ODI questionnaire referenced above (the initial response is attached as Attachment 2.1, the revised exhibit as Attachment 2.2, and the supplemental response as Attachment 2.3) indicated that, at some point in its history WSLIC or its predecessors in interest or companies whose business it acquired, had marketed some of their life insurance products using rates which explicitly distinguished between white and non-white insureds. Accordingly, all of the companies' (including companies whose business had been acquired or reinsured by WSLIC) rate books were solicited from WSLIC, together with any other rate documentation information, and those provided were reviewed to determine whether premium rate differentials based on the race of the insured existed. This review included not only a search for any rate differentials explicitly based on race, but also a review of any underwriting classification mechanisms (standard, preferred, regular, substandard, etc.) in order to determine whether statistically these had the effect of creating premium differentials according to the race of the insured. It is important to note that we have relied on the personnel of WSLIC to provide

us with all rate books, other rate documentation, and all of the information contained in those rate books and rate documentations. WSLIC has also provided the examiners with a description of the information available on their data base with respect to death claims, maturities, and surrenders of WPI and ordinary business. This information is shown in Attachment 2.4. The examiners are pleased to report the cooperative and responsive nature of the representatives of the company in conjunction with our work on this report. An affidavit, signed by an officer of WSLIC, attesting to the relevance and completeness of the information provided is included as Attachment 3.

When WSLIC became aware of the NAIC's desire in 1988 to obtain information on the race based pricing activities of life insurance companies, they voluntarily implemented an internal program to first identify those industrial and ordinary policies in force with WSLIC that were priced on a racially distinct basis and still in force on a premium paying basis. Once identified, WSLIC provided an increased amount of insurance protection to these policyholders. The amount was designed to provide insurance equivalent to that provided to a white insured under a similar plan and premium rate. Premiums thereafter continued to be paid at the same level as prior to the increase. The examiners noted that the policyholders themselves received no notification of the increased amount of insurance protection. In addition, the program only applied to policyholders still in a premium paying status with WSLIC and not to policies in force as reduced paid up insurance or extended term insurance or to policyholders whose coverage was no longer in force. Additional details regarding this adjustment program are covered later in this report.

In 2000 and 2001, in response to the 2000 NAIC questionnaire in this regard, WSLIC additionally enhanced all then in force industrial and ordinary policies issued with premiums determined on a racially distinct basis. At that time, per unit nonforfeiture values were increased for all policies with values based on a substandard industrial mortality table. Both base policy benefits and paid up additions were enhanced to reflect coverages that would have been provided had the policies been issued on a non-racially distinct basis. All affected in force policies were included although the program did not apply retroactively, even in respect of those non-premium paying policies that had been in force in 1988 and had surrendered, matured, or been paid out as a result of the insured's death since that time. Additional details regarding this adjustment program are covered later in this report.

Reliances

As indicated previously in this report, this examination covers the pricing activities of WSLIC (and its reinsured business) as they relate to life insurance. The term "life insurance" is not restrictive and refers to life insurance sold by the companies under labels such as "industrial life insurance", "monthly debit ordinary (MDO) insurance", "burial insurance", "vault insurance", "monument insurance", "merchandise insurance", "monthly intermediate ordinary (MIO) insurance", "monthly account ordinary (MAO) insurance", "home service insurance", and "ordinary insurance". The types of insurance covered are also not restricted to the marketing methodology employed or to the particular type of insurance sales license under which the product is or was marketed.

In preparing this report, we have relied on the accuracy and totality of the information requested, as provided by certain WSLIC personnel. The information provided included but was not limited to, the following:

1. Rate book information on the life insurance of WSLIC and its reinsured business.

2. Other rate documentation information as historically assembled by WSLIC, including rate documentation for its reinsured business.

3. Policy file information for the policies chosen for sampling purposes.

4. Premium rate methodology documentation.

5. Various extracts provided on electronic media of WSLIC's administrative databases.

6. Various policy forms, including applications.

7. Information in various forms on the extent and amount of any remedial action implemented by WSLIC in respect of policies issued using premium rates determined on an explicitly race-distinct basis.

8. Internal company memos and documents retrieved by Mr. Tom Neiswander, Investigative Officer of the ODI.

Limitations

In certain situations, limitations of one form or another precluded reaching a 100% accurate conclusion regarding the race based pricing activities of WSLIC or the companies it had acquired with respect to its life insurance business. Among these:

1. The passage of a substantial number of years between the present and the period when WSLIC (or its predecessors in interest or companies whose business it acquired) had, or potentially had, marketed life insurance policies with racially distinct premium rates. Personnel have changed and files are not readily available. These older historical files contain significantly less information compared to that available regarding presently issued insureds.

2. The fact that WSLIC had, over the years, acquired numerous companies, either through an assumption reinsurance arrangement or through acquisition of a company's stock. Rate book and pricing information obtained in respect of business acquired in this fashion tended to be incomplete or unavailable and lacking in descriptions of the underwriting approach used for the products. No pricing information was available to provide insight into the mortality assumptions used, if any, in determining premiums.

3. The lack of any consistent and well documented relationships between plan codes used in rate books and those contained on WSLIC's administrative systems.

Details of Examination

WESTERN AND SOUTHERN LIFE INSURANCE COMPANY (WSLIC)

Pre-1957 Weekly Premium Industrial (WPI)

WSLIC began this period in 1888 as a stock company and ended it as a mutual company (1948). The examiners reviewed all available WSLIC rate books used during this period of time to attempt to determine any distinctions in rates or underwriting methodologies based on the race of the applicant. In addition, policy forms were reviewed to determine whether nonforfeiture bases varied by plan.

Seriatim listings were provided by WSLIC for the seven largest plans in force as of 12/31/2000. These plans were selected by the examiners in order to provide a general range of plans offered by WSLIC during this period in terms of coverage period, premium paying period, and status (premium paying, paid up, ETI, etc.). Since race was not contained on the master policy record, a random sample of policies was selected from the seriatim listings for these plans. ODI personnel then researched these files to attempt to obtain the race of the applicant from information contained therein, if possible. The result of that analysis is contained in Attachment 4 of this report.

A review of the results of the sampling performed on the chosen plan codes (these plan codes represented over 93% of the in force business of WSLIC as of 12/31/2000) indicates that, in

those situations where the race of the applicant was determinable, 99% of those applicants were white. This result is consistent with the history of WSLIC's career agent marketing efforts which indicate that their marketing thrust was in primarily white areas. Since WPI policies were not issued on a rated basis (they were either accept or reject), the examiners were unable to determine whether non-white applicants were actually rejected for coverage versus not merely, as a general rule, solicited for coverage.

The examiners obtained specimen policy forms in respect of the plans sampled and determined that, for these plans, the 1941 Standard Industrial Mortality Table was used for nonforfeiture values. The same policy form was used for white applicants as for non-white applicants although, as indicated above, the vast majority of applicants, where identifiable, were white. In fact, of the 386 sample policies drawn, 144 of them, or 37.3%, contained no information in the files as to the race of the applicant. The application forms used by WSLIC for these policies did solicit information on race on the application until 1965 although the race of the insured was not included in WSLIC's master record for the policy.

The examiners concluded that race was not a factor used in determining premiums for the WPI policies issued by WSLIC during this period although sampling indicated that WSLIC policies were almost exclusively issued to white policyholders.

WPI/MPI Issues of 7/1/57 Through 3/31/58

The examiners determined that during this period of time WSLIC offered its WPI portfolio on a Regular and standard basis. Separate and distinct plans were made available in each of these two classifications except for the Monthly Premium Industrial (MPI) Endowment at Age 18 policy which was offered to both Regular and standard applicants.

Rate book and internal WSLIC document information, attached as Attachment 5, analyzed by the examiners indicate that the Regular series WPI policies were marketed to non-white applicants and standard series policies marketed to whites. For the most part, the existing career sales force of WSLIC continued to have available only the standard series policies. WSLIC's revision of its WPI portfolio to essentially add a Regular series of policies available to non-whites appears to have been motivated by pressure from the sales forces of companies whose business was acquired by WSLIC in 1957 and who would continue to market products for WSLIC. Examples of such documentation are included as Attachment 6.

It should be noted that, even though separate and distinct plans were made available in each of the Regular and standard series of plans, the examiners determined that, even after adjusting for plan differences, the Regular series rate appeared to have been based on a higher underlying mortality assumption than those of the standard series. Attachment 7 illustrates the examiners' analysis used to reach this conclusion for the Eighteen Pay Life Regular series plan versus the Twenty Pay Life standard series plan. Attachment 7 illustrates that, using an identical mortality table, the underlying mortality premium (i.e. net premium) differential attributable to the plan

differences are minimal (5% to 8% - see Attachment 7, Column C) for each issue age while the gross premium differentials are significant (20% to 26% - see Attachment 7, Column A). Had the underlying mortality been similar in the development of the premiums for these two plans, the gross and net premium differentials would be expected to be much closer. Put another way, it would be reasonable for an 18-Pay Life plan to have premiums which are about 5% to 8% higher than a 20-Pay Life plan based simply on the fact that there are fewer premium payments required for the same coverage. However, since the actual gross premium differentials are much higher (20% to 26%) this implies that a higher underlying mortality assumption was the source of the higher differential. In fact, in this situation, the examiners were able to virtually reproduce (within 1 cent or less) the Regular series weekly gross premiums (see Attachment 7, Column G&H) by multiplying the substandard net (1941 Substandard Industrial Mortality Table) premium by the standard plan loading factor (loading factor = the standard plan gross premium divided by the 1941 Standard Industrial Mortality Table net premium). Thus, it seems apparent based on this analysis, that the premiums for the Regular series plans were inherently based on a higher mortality assumption vis-à-vis the standard series. In the analysis presented in Attachment 7, this higher mortality assumption is represented by the 1941 Substandard Industrial Mortality Table in comparison to the 1941 Standard Industrial Mortality Table.

Regarding the nonforfeiture mortality tables for the Regular and standard series forms, the examiners determined that, for the standard series, the 1941 Standard Industrial Mortality Table was used (see Attachment 8 from a standard series form) while for Regular series forms the 1941 Substandard Industrial Mortality Table was used (see Attachment 9 from a Regular series policy). It should be noted that the mere use of a substandard mortality table in one policy form

for nonforfeiture values and a standard mortality table in another is not, in and of itself, an indication that gross premium rates varied by race (due to the fact that actual gross premiums charged do not necessarily bear any relationship to the nonforfeiture values offered in the policy), although in this situation that was the case.

During this time period, WSLIC also developed what was known as the Thrift series of policies, and their counterpart the Security series of policies, which were to be marketed to non-white and white risks, respectively. Although the Thrift series and Security series of policies were technically of the MDO variety, they have been included in this section of the report since their availability matched the time period when the Regular and standard series WPI/MPI products were available and they utilized premium rates which varied based on the race of the insured. Unlike the Regular and standard series of policies, the Thrift and Security series policy offerings (including nonforfeiture values which for both series were based on the 1941 Standard Ordinary Mortality Table) were the same, with higher premium rates being charged for a Thrift series policy vis-à-vis its Security series counterpart. A sample nonforfeiture rate page for a comparable plan is attached as Attachment 10, where this same nonforfeiture rate page is applicable to both the Thrift series and Security series plans.

WSLIC Ordinary Series Policies (non-MDO)

The examiners reviewed rate books and internal memos retrieved by Tom Neiswander in order to determine the extent of any explicit race based distinctions in premium rates for this class of policies and to determine whether underwriting practices effectively resulted in racially distinct

premiums. An internal document from 1947 (attached as Attachment 11) indicates that African-American applicants for ordinary policies were automatically rated Table B (plus 50%) because of their race. A later document from 1954 (Attachment 12) indicates that African-Americans were to be underwritten similarly to other non-white applicants with no automatic Table B rating due to race. A seriatim listing of all ordinary policies in force which were rated was provided by WSLIC and the examiners selected samples from this group in order to determine first whether any of these insureds were non-white and second whether the ratings could reasonably be assumed to have been applied because of the applicant's race. The results of the sampling are shown in Attachment 13. As can be seen by the results in this Attachment, there is insufficient statistical evidence to support the concept that race based underwriting techniques were employed by WSLIC for ordinary plans. In fact, only 1 policy out of 20 rated policies sampled was identified as being non-white.

The samples drawn indicated that the vast majority of the insureds were white and that, where the insured was non-white, the rating appeared appropriate to the medical characteristics of the applicant.

LIFE INSURANCE BUSINESS ACQUIRED BY WSLIC FROM OTHER ENTITIES

Beginning in 1954 and continuing through 1970, WSLIC acquired a number of life insurance companies. See Attachment 14. In many cases, the field forces of these companies were acquired as well and became licensed agents for WSLIC. As an accommodation to these agents, WSLIC continued, in certain situations in 1957, the premium rating and underwriting structures

of these companies, for the 7/1/57 through 3/31/58 period noted above. The examiners reviewed all premium rate information available in respect of the business acquired by these companies, internal company memos relating to the business acquired, and memos relating to the methodology used to determine which of these policies, if any, were eligible for WSLIC's 1988 and 2000/2001 enhancement programs. The details of these programs are outlined later in this report.

Using the information available, the examiners attempted to determine whether any policies issued by the companies prior to being acquired by WSLIC utilized premium rate structures which varied based on the race of the applicant, either explicitly or by virtue of the underwriting procedures employed. In many cases, underwriting procedures were not provided to WSLIC at the time the business was acquired and, as a result, premium rate information and internal company memos became the primary source of information for the examiners.

Industrial Business

The procedures followed by the examiners in this regard consisted of first reviewing any available rate book and other rate information applicable to the business acquired, and reaching preliminary conclusions with regard to any racial distinctions in premiums with respect to the business. The examiners determined that WSLIC acquired from other companies industrial policies issued at least as early as 1913. An attempt was then made to reconcile the plans involved, if any, with the detailed analysis performed by WSLIC in this regard as part of their policy enhancement activities. A description of the procedures used by WSLIC to determine the

affected plans (for the WPI business of Imperial Life of North Carolina) is included as Attachment 15. This procedure is representative of the procedures used to determine whether the WPI/MPI business WSLIC acquired when it purchased other carriers utilized premiums based on the race of the insured. The examiners reviewed these procedures and found the methodology appropriate and complete as to the identification of any WPI/MPI business acquired by WSLIC that utilized racially distinct premium rates.

The examiners' analysis indicated that the in force policy forms determined as being priced on a racially distinct basis essentially duplicated those determined through the efforts of WSLIC as part of their enhancement process. As a result, no sampling of these plan codes to insure that the database reflected premium rates consistent with the rate book involved was undertaken since such an effort would have been redundant and would have duplicated the extensive efforts performed by WSLIC in this area. The accuracy of WSLIC's analysis of premiums was part of the examiners' effort to review the details of the policy enhancement programs.

As an example, the examiners' review of the rate book and other rating information in respect of Imperial Life Insurance Company of North Carolina indicated that its WPI/MPI business had, for the most part, premium rate structures which varied on a racially distinct basis. Sample pages from the rate books involved are included as Attachments 16.1 and 16.2.

Ordinary Business

In respect of the ordinary business acquired by WSLIC through assumption reinsurance, the examiners again reviewed all available rate books and rate material provided by those companies, as well as internal memorandums and meeting minutes covering the procedures used to identify reinsured policies may have utilized premiums reflecting the race of the insured. As with the WPI/MPI assumed business, in both 1988 and 2000/2001 WSLIC performed an extensive analysis of the reinsured ordinary business in conjunction with their policy enhancement programs at the time. The examiners reviewed the procedures utilized by WSLIC in an attempt to identify policies using racially distinct premiums.

Ordinary business, including MAO business, is priced utilizing a single base rate with substandard, or additional, premium ratings determined by the underwriters when and as appropriate. The thrust of WSLIC's approach to identifying policies with race based premiums was first to identify all substandard rated policies assumed from other companies and then to determine whether this rating was applied as a result of the race of the insured.

The examiners reviewed the procedures used by WSLIC in this regard and determined that, because of the exhaustive nature of WSLIC's efforts, no additional analysis was deemed appropriate. These procedures are documented in Attachment 17.

RACED BASED PREMIUM POLICY BENEFIT INCREASES IMPLEMENTED BY WSLIC

In both 1988 and 2000/2001, WSLIC implemented procedures where the benefit amounts for certain in force policies with racially distinct premiums were increased to reflect the differentials in premiums charged to white and non-white policyholders. Methods utilized by WSLIC to identify such affected policies were extensive and included the examination of rate manuals, the review of applications and the analysis of master administrative data. Through its analysis, WSLIC was able to identify numerous plans that had been issued either on an explicitly racially distinct premium basis, where certain rates or plans were clearly indicated to be used for non-white applicants, or issued on a two-tiered type basis (e.g. Standard/Preferred, Standard/Substandard) where separate premiums and/or plans were utilized for non-white applicants.

The first of the two benefit increase programs took place in 1988 where benefits, in the form of a special dividend, were increased for all in force premium paying policies that had been identified as having premiums based on race. There were 10,656 policies that had their benefits increased at this point in time with a total increase in face amount of $715,832 and a corresponding increase in cash values or reserves of $359,267. The vast majority of affected policies were WPI policies that had been assumed by WSLIC from other companies. See Attachment 18. The rationale utilized in determining the amount of the benefit increases will be discussed later in this report.

In 2000 and 2001, WSLIC implemented a second program of benefit increases for policies that had been issued with premiums based on race. Apart from a small number of premium paying policies not identified as part of the 1988 benefit increases, the race based premium policies adjusted in 2000/2001 were non-premium paying (reduced paid up, fully paid up, extended term) policies. As in 1988, where applicable, dividend accumulations and paid up additions were increased in addition to the basic face amount increases. There were 45,454 policies that had their benefits increased in 2000/2001 with a total increase in face amount of $1,270,169 and an increase in cash values or reserves of $823,576. As in 1988, the vast majority of affected policies were WPI policies that had been assumed by WSLIC from other companies. See Attachment 19.

Additional adjustments were also made in 2000/2001 to a portion of the above affected WPI policies with nonforfeiture values based on a substandard mortality table (i.e. Substandard Industrial, 1941 Substandard Industrial). These adjustments increased nonforfeiture benefits, in situations where beneficial, to the level that they would have been had a standard mortality table (i.e. Standard Industrial, 1941 Standard Industrial) been utilized to compute nonforfeiture values. WSLIC estimated the cost of these additional enhancements to be somewhere between $150,000 and $200,000.

Attachment 19.1 includes a summary by state of all policyholders impacted by the enhancement programs implemented by WSLIC in 1988 and 2000/2001.

WSLIC Adjustment Ratio Determination

In determining the appropriate increase in death benefits to provide in both 1988 and 2000/2001, WSLIC compared the actual premium charged to a non-white policyholder to a comparable premium that would have been charged to a white policyholder in calculating an Adjustment Ratio. By applying this Adjustment Ratio, the benefits on a policy with premiums determined on a racially distinct basis were augmented to the level that they would have been if they were charged rates for their insurance coverage that were applicable (or comparable) to white lives. Attachment 19.2 includes a summary of the average Adjustment Ratios computed by WSLIC as part of the 1988 and 2000/2001 enhancement programs. As this Attachment indicates for the policyholders impacted by these two programs, non-white policyholders were charged, on average, 18.4% higher premiums compared to white policyholders.

In general, there are two different types of situations involved in determining the appropriate increase in death benefits. The first type of situation is where identical plans were issued to both whites and non-whites but with different premium rates. Alternatively, there were many situations where specific plans were offered exclusively to non-white applicants with no directly comparable white plan.

For plan types in which identical plans were issued to whites and non-whites, computing the Adjustment Ratio to apply to the current face amount was relatively straightforward. For these situations, the factor applied to the current face amount was calculated as the non-white gross premium divided by the comparable white gross premium for the identical plan, issue age and

face amount. The following hypothetical example will demonstrate the details of this type of adjustment.

Example 1

Plan: Endowment @ Age 75

Original Face Amount = $500

Issue Age = 35

Non-White Gross Weekly Premium = .45

White Gross Weekly Premium = .35

Adjustment Ratio = .45/.35 = 1.28571

Adjusted Face Amount = $500 x 1.28571 = $642.86 (rounded to higher dollar)

This type of situation, where a comparable white plan was available, existed in 2000/2001 for the WSLIC MDO Thrift series plans, where the comparable white plans were known as Security series plans. The examiners verified the calculation of the Adjustment Ratio for a sample of the MDO Thrift series policies adjusted in 2000/2001. The results of this sampling are included in Attachment 20.

For situations in which plans were offered exclusively to non-whites (with no directly comparable white plans), a different approach was utilized by WSLIC to determine the Adjustment Ratio. This approach outlined in Attachment 21, involved the calculation of a "net" premium, which is an actuarially computed premium based on a specific mortality table and

interest rate. Note that a "gross" premium can be thought of as having two basic components - a net premium plus a loading, where the loading is intended to cover items such as expenses and profit for the company.

In these situations, the Adjustment Ratio was calculated as the gross annualized non-white premium (GANWP) divided by a "standard" gross annualized premium (SGAP). For WPI policies, the GANWP is calculated as the weekly premium times 52.142857 (52 plus 1/7). The first step WSLIC took in calculating the SGAP was to compute the absolute loading utilized to calculate the GANWP. This absolute loading was defined as the GANWP less the net annual premium based on a substandard mortality table (typically the 1941 Substandard Industrial Mortality Table). This loading was then added to a net annual premium based on a standard mortality table (typically the 1941 Standard Industrial Mortality Table) to calculate the SGAP. Again, the following hypothetical example will help to demonstrate the details of this type of calculation for plans issued exclusively to non-whites.

<u>Example 2</u>

Plan: Endowment @ Age 75

Original Face Amount = $500

Issue Age = 35

Non-White Gross Weekly Premium = .45

Gross Annualized Non-white Premium (GANWP) = .45 x 52.142857 = 23.46

Substandard Net Annual Premium = 15.08 (Based on the 1941 Substandard Industrial Mortality Table and 3% interest)

Thus, the absolute loading equals 8.38 (23.46 - 15.08).

Standard Net Annual Premium = 11.86 (Based on the 1941 Standard Industrial Mortality Table and 3% interest)

Standard Gross Annualized Premium (SGAP) = 11.86 + 8.38 = 20.24

Adjustment Ratio = GANWP/SGAP = 23.46/20.24 = 1.159

Adjusted Face Amount = $500 x 1.159 = $579.50 (rounded to higher dollar)

This type of situation, where a comparable white plan was not available, existed in 2000/2001 for the WSLIC WPI Regular series plans. The examiners verified the calculation of the Adjustment Ratio, based on the methodology above, for a sample of the WPI Regular series policies adjusted in 2000/2001. The results of this sampling are included in Attachment 22.

Upon review of the two methodologies utilized by WSLIC set forth above, it appears that these methodologies are somewhat inconsistent. The first methodology set forth above, where identical plans were issued to both whites and non-whites, utilizes a ratio of gross premiums. Viewed in the conceptual framework of the net premium approach described above, the loading

utilized to calculate the white gross premium would typically be comparable to the non-white loading (based on a substandard net premium) on a percentage basis, not on an absolute basis. In fact, two primary components of loading – commissions and profits – are typically expressed in terms of a percentage of premium.

Thus, the examiners feel that it would be more appropriate to calculate the loading on a percentage basis instead of an absolute basis for cases where comparable white plans are not available. This would be more consistent with the methodology utilized when comparable white premiums are available and would lead to larger Adjustment Ratios (and thus, enhanced benefits) for affected non-white policyholders virtually in all circumstances. The following example demonstrates the impact of utilizing a percentage of loading basis and the effect on the Adjustment Ratio calculated in Example 2 above.

Example 3 (Modification of Example 2)

Plan: Endowment @ Age 75

Original Face Amount = $500

Issue Age = 35

Non-White Gross Weekly Premium = .45

Gross Annualized Non-white Premium (GANWP) = .45 x 52.142857 = 23.46

Substandard Net Annual Premium = 15.08 (Based on the 1941 Substandard Industrial Mortality Table and 3% interest)

Thus, the percentage loading equals 155.57% (23.46/15.08).

Standard Net Annual Premium = 11.86 (Based on the 1941 Standard Industrial Mortality Table and 3% interest)

Modified Standard Gross Annualized Premium (MSGAP) = 11.86 x 155.57% = 18.45

Adjustment Ratio = GANWP/MSGAP = 23.46/18.45 = 1.272 (vs. 1.159 above)

Adjusted Face Amount = $500 x 1.272 = $636.00 (10% higher than $579.50 above)

The Adjustment Ratios for the WSLIC WPI Regular series samples in Attachment 23 were recalculated based on the percentage basis methodology suggested above. The results of these revised Adjustment Ratio calculations indicate benefit increases that vary from 6.0% to 13.1% relative to the original Adjustment Ratios computed by WSLIC.

Conclusions

As stated previously, the purpose of this special multi-state examination is to make a determination of whether, and to what extent, the premium structures of the business of WSLIC (and of the companies whose business was acquired or assumed by WSLIC) reflect, in fact or in effect, differentials based on the race of the insured. This section of the report attempts to

document the conclusions the examiners have reached in this regard. The findings of this examination are as follows:

1. During the period 7/1/57 through 3/31/58, WSLIC offered separate WPI and MPI plans to its white applicants and to its non-white applicants (although one plan, the MPI Endowment at 18 was available to both white and non-white applicants at different rates). WSLIC's Regular/standard series policies were priced on a racially distinct basis, with higher rates for non-whites (Regular) than whites (standard) even after considering plan differences between the Regular and standard plan series.

2. During the period 7/1/57 through 3/31/58, the nonforfeiture values available under WSLIC's Regular series forms were based on the 1941 Substandard Industrial Mortality Table while those under its standard series forms were based on the lower mortality rates inherent in the 1941 Standard Industrial Mortality Table.

3. During the period 7/1/57 through 3/31/58, WSLIC's MDO Thrift and Security series plans were priced on a racially distinct basis and, although the plans and benefits in each series were identical, the premium rates charged for the non-white Thrift series forms were higher than those for the white Security series forms.

4. Premium rates applicable to policies acquired by WSLIC when it acquired other insurers were, in some cases, racially distinct (the majority of these were WPI). The plan types

affected and period of time applicable to the race distinct pricing practice varied by company.

5. In 1988, WSLIC attempted to identify all then in force premium paying WSLIC and reinsured company plans for which a higher premiums was charged due to the race of the insured. Based on the examiners' analysis, and on the available information, this effort appears to have been diligently performed.

6. In 2000/2001, WSLIC attempted to identify all then in force WSLIC and reinsured company plans for which a higher premium was charged due to the race of the insured. Based on the examiners' analysis, and on the available information, this effort appears to have been diligently performed.

7. The policy enhancement calculations performed by WSLIC in respect of policies utilizing premiums which varied based on the race of the insured were reviewed by the examiners in detail. An inconsistency in the calculation of the Adjustment Ratios in situations where the "net" premium approach was utilized became apparent during this review.

Recommendations

After reviewing the factual information obtained as a result of this examination and the additional information developed from an analysis of that information and data, as well as the

enhancement programs and calculations performed by WSLIC, the examiners recommend the following course of action be undertaken.

1. Modify the enhancement program, as previously applied, to change the Adjustment Ratios (utilized by WSLIC to calculate the benefit amount enhancements) to a percentage basis from an absolute basis for those situations where a "net" premium approach was used.

2. Extend the enhancement program, as modified, to include all policies issued using racially distinct premiums. The extended program would not include any policy granted an enhancement pursuant to the 1988 and 2000/2001 programs, except as modified according to 1. above. For affected race based policies terminated prior to the implementation date of this extended program, remediation will be provided only to these policies where a benefit has been paid out by WSLIC (i.e. deaths, maturities, surrenders).

Company Response To Draft Report

WSLIC's response to the draft report, dated March 31, 2003, is included as Attachment 24. No changes were made in this final report as a result of the company's response.