LIFE INSURANCE (C3) SUBCOMMITTEE

Reference:
1976 Proc. Vol. II p. 541
1977 Proc. Vol. I p. 478

Hon. Dick L. Rottman, Chairman -- Nevada
Hon. Maximilian Wallach, Vice-Chairman -- District of Columbia

AGENDA

1. Report of the Technical Task Force on Standard Nonforfieture and Reserve Valuation Laws.
2. Report of the Life Insurance Cost Comparison Task Force on study of life insurance dividend practices, annuity disclosure and life insurance policy lapsation.
3. Report of Life Insurance Agent's Compensation Task Force.
4. Report of the Life Insurance Replacement Regulation Task Force.
5. Any other matters brought before the subcommittee.
6. Prepare report summary, list of recommendations for action and list of unfinished ongoing committee business for inclusion in the report of the meeting.

The Life Insurance (C3) Subcommittee convened on Tuesday, June 7 at 10:00 a.m. in the North Hall No. 1, Radisson Hotel, Minneapolis, Minnesota. The meeting was chaired by Commissioner J. Richard Barnes of Colorado.

Report of the Technical Task Force on Standard Nonforfeiture and Reserve Valuation Laws

This report was given by John Montgomery of the California Department, Chairman of the task force. He spoke briefly on the fact that the technical task force had reviewed the recommendation made in the special report to the (C3) Life Subcommittee dated May 2, 1977 and decided not to make the recommendation at this time. The explanation of this decision is included in the task force report which is attached.

Mr. Montgomery also distributed corrections to pages 484 through 492 of the (C3) report as printed in the 1977 NAIC Proceedings Vol. I. These are printers errors which should be corrected. He asked the subcommittee to include these corrections in its final report (corrections attached).

Richard Minck, American Council of Life Insurance, asked that the page of the Standard Nonforfeiture and Reserve Valuation Laws report which serves as an index to the attachments included in the report, be corrected to include Attachment N. Attachment N refers to two memorandums; (1), a memorandum in support of lowering the minimum reserve standards for group annuities purchased prior to the operative date of the 1972 amendments to the standard valuation law by increasing the statutory valuation interest rate; and (2), proposed guidelines for use by insurance commissioners in approving any destrengthening of group annuity reserves under new minimum reserve standards for annuities purchased prior to the operative date of the 1972 NAIC amendments to the standard valuation law, which are included in the report.

Report of the Life Insurance Cost Comparison Task Force on the Study of Life Insurance Dividend Practices, Annuity Disclosure and Life Insurance Policy Lapsation

Commissioner Herbert W. Anderson of the Iowa Department, Task Force Chairman, reported that the task force had been inactive since the last meeting. He had previously recommended appointment of a new chairman.

Report of the Life Insurance Agent's Compensation Task Force

Ted Becker of the Texas Department reported the task force had received the second report of the Life Insurance Marketing and Research Association (LIMRA) and the industry advisory committee and that they expected to have the study completed and a recommendation for the subcommittee at the December meeting. The second LIMRA report is included with the task force report which is attached.

Life Insurance Replacement Regulation Task Force

Director M. Berri Balka of the Nebraska Department, Chairman, presented the report. Director Balka included in the report a second exposure draft of a revised model life insurance replacement regulation. He stated it was the intention of the task force to meet early this fall to discuss technicalities involved in drafting the third draft of Exhibit A to the replacement regulation. The task force report and the proposed regulation are attached.

Other Topics Brought Before the Subcommittee

Keith Sloan of the Arkansas Department requested the (C3) Subcommittee to appoint a task force to study and develop uniform standards for life insurance policy language simplification.

Commissioner J. Richard Barnes, Colorado, spoke briefly on IRS Ruling 77-85 regarding federal tax treatment of investment annuities. Commissioner Barnes told the subcommittee he felt that the NAIC should be informed of the action of the federal government and should give some thought to what the NAIC's position should be in this regard. He distributed a memorandum to the subcommittee which summarized the federal tax treatment of investment annuities. The memorandum is attached.

Executive Session

Commissioner Barnes congratulated John Montgomery and his task force on the excellent work they have been doing on the standard nonforfeiture and reserve valuation law revisions. This task force report was received in executive session. It was directed that the corrections to the report also be adopted.

Commissioner Anderson asked the (C3) Subcommittee to recommend to the chairman of the committee the appointment of a new chairman of the Life Insurance Cost Comparison Task Force due to the budget and time inability of Iowa to take the lead. This recommendation was adopted in executive session.

The Agent's Compensation Task Force report was received in executive session.

The Life Insurance Replacement Regulation Task Force report was also received in executive session. Director Balka asked the (C3) Subcommittee for guidance on drafting a proposed model life insurance disclosure regulation. The subcommittee recommended that the task force should proceed as if the disclosure regulation had been adopted by the states at the same time as, or prior to, the proposed revised replacement regulation being considered. It was also suggested by the subcommittee that possible footnotes to the replacement regulation be drafted to make reference to changes necessary if a state does not adopt the life insurance disclosure regulation.

The subcommittee voted to accept Mr. Sloan's recommendation and to direct the (C3) Subcommittee chairman to appoint a new task force to make recommendations on life policy language simplification.

Commissioner Barnes explained in the executive session that he expected to receive information on the content of the federal government's brief in answer to the First Investment Annuity Company's complaint in the next few days. He stated that when he received their information he will make a further report to either the (C) Committee or the Executive Committee, whichever committee would be appropriate, based on the time of receipt of such information.

The meeting was adjourned at approximately 11:20 a.m.

Hon. Dick L. Rottman, Chairman, Nevada; Hon. Maximilian Wallach, Vice-Chairman, District of Columbia; Hon. William H. L. Woodyard III, Arkansas; Hon. J. Richard Barnes, Colorado; Hon. Herbert W. Anderson, Iowa; Hon. Edward J. Birrane Jr., Maryland; Hon. Jerry B. Buxton, Missouri, Hon. James J. Sheeran, New Jersey; Hon. Peter F. Mullaney, Rhode Island, Hon. Clifton N. Ottosen, Utah; Hon. John G. Day, Virginia.

Follow Up on the Special Report of May 2, 1977 to the (C3) Life Subcommittee
by the Technical Task Force on Valuation and Nonforfeiture Value Regulation

June 5, 1977

The technical task force has reviewed the recommendation made in the special report to the (C3) Life Subcommittee dated May 2, 1977, and has decided not to make the recommendation at this time. This was prompted by legislation introduced in one state making the new valuation interest rates for annuities in such legislation effective retroactively. The result of this legislation would be to provide surplus relief to a number of companies from the strain that had been imposed by an interpretation by that state's insurance department with respect to the valuation of single premium deferred annuities with interest guarantees in excess of the maximum permissible valuation interest rate.

The task force recognizes that some states may have passed legislation, or are in the process of enacting legislation, which would follow that of Recommendation 3 proposed at the December 1976 meeting but not adopted by the NAIC. At that meeting the Executive Committee of the NAIC had overruled the committee and (C3) Subcommittee recommendations and sent Recommendation 3 back to the task force to draft guidelines for the implementation of such legislation.

The technical task force requests that the Special Report of May 2, 1977 be included in the Proceedings of the NAIC so that it may be referred to by those states in which such legislation has been enacted but that the recommendation be recorded as received but not adopted.

John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; William A. White, New Jersey; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah; Bradford S. Gile, Wisconsin.

SPECIAL REPORT

To the (C3) Life Insurance Subcommittee by the (C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation

Concerning Proposed Revisions to Standard Valuation Law and Accompanying Guidelines

May 2, 1977

This special report contains one recommendation in two parts which the Valuation and Nonforfeiture Value Technical Task Force urges the NAIC (C3) Life Subcommittee to adopt at its meeting in June 1977. An additional report to be filed by the task force in June will contain the routine proceedings of the technical task force since the December 1976 NAIC meeting.

The recommendation made in this special report concerns the revision of the standard valuation law with respect to annuities and pure endowments purchased prior to the operative date of the 1972 NAIC amendments to the standard valuation law under group annuity and pure endowment contracts and is the same as Recommendation 3 of the November 4, 1976 special report of the NAIC technical task force which was adopted by the (C3) Life Subcommittee but rejected in the final plenary session of the NAIC with the condition that the recommendation would be reconsidered if a set of guidelines for approving any destrengthening of group annuity reserves under the new minimum reserve standards was developed by the technical task force.

The recommendation consists of two parts:

A. Revision of the standard valuation law to increase from 3½% to 5% the statutory interest rate used in determining minimum reserve standards for group annuities purchased prior to the operative date of the 1972 NAIC amendments to the operative date of the 1972 NAIC amendments to the standard valuation law (Attachment A).

B. Guidelines for use by the insurance commissioners in approving any destrengthening of group annuity reserves under the new minimum reserve standards specified in part A above.

John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; William A. White, New Jersey; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah; Bradford S. Gile, Wisconsin.

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ATTACHMENT A

Recommendation Concerning Section 3 of the Standard Valuation Law

(The added wording is underlined.)

3. Except as otherwise provided in Section 3-a, the minimum standard for the valuation of all such policies and contracts issued prior to the effective date of this Act shall be that provided by the laws in effect immediately prior to such date, except that the minimum standard for the valuation of annuities and pure endowments purchased under group annuity and pure endowment contracts issued prior to such effective date shall be that provided by the laws in effect immediately prior to such date but replacing the interest rates specified in such laws by an interest rate of 5% per annum. Except as otherwise provided in Section 3-a, the minimum standard for the valuation of all such policies and contracts issued on and after the effective date of this Act shall be the commissioner's reserve valuation methods defined in Sections 4, 4-a and 7, 5% interest for group annuity and pure endowment contracts and 3½% interest for all other such policies and contracts or in the case of policies and contracts other than annuity and pure endowment contracts, issued on or after (insert effective date of 1972 NAIC amendments to the standard valuation law), 4% interest for such policies issued prior to the effective date of this amendatory act of 197___, 5½% interest for single premium life insurance policies and 4½% interest for all other policies issued on or after the effective date of this amendatory act of 197___, and the following tables:

(Remainder of Section 3 is unchanged)

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ATTACHMENT B

Guidelines for use by Insurance Commissioners in Approving Any Destrengthening
of Group Annuity Reserves Under New Minimum Reserve Standards for Annuities Purchased
Prior to the Operative Date of the 1972 NAIC Amendments to the Standard Valuation Law

These guidelines set forth factors which should be considered by a commissioner in approving any reserve destrengthening for existing blocks of group annuities resulting from enactment of the standard valuation law which would increase from 3½% to 5% the statutory interest rate used in determining minimum reserves standards for group annuities purchased prior to the operative date of the 1972 NAIC amendments to the standard valuation law. Such enactment would make it possible for group pension writers to destrengthen reserves for existing group annities in recognition of the fact that, in most cases, reserves for such annuities based upon a 3½% interest earnings assumption have proved to be redundant. (Most insurers in 1976 were earning from 6% to 6½% on funds underlying group annuities purchased prior to the operative date of the 1972 NAIC amendment to the standard valuation law.) The approval of the commissioner to destrengthen reserves is required under the last paragraph of Section 6 of the standard valuation law which states:

> Any such company which at any time shall have adopted any standard of valuation producing greater aggregate reserves than those calculated according to the minimum standard herein provided may, with the approval of the commissioner, adopt any lower standard of valuation, but not lower than the minimum herein provided.

1. Requirements for Destrengthening

The commissioner should ask companies who request permission to destrengthen reserves to explain the financial conditions which make it appropriate to hold smaller reserves. Such companies should be prepared to demonstrate that the expected future investment earnings on the funds (actuarial asset shares) supporting the annuities for which reserves are to be destrengthened will be adequate to meet both future minimum reserve requirements and future obligations for this business based upon adequate and current mortality assumptions in relation to expected emerging mortality experience of annuitants. The Group Annuitants Mortality Table used for current new issues would be acceptable as a reasonable mortality assumption for these purposes. The expected future investment earnings used in the demonstration should be based on the method, either investment-year method or aggregate-portfolio method, actually used by the insurer to allocate investment income to the group annuity line of business. One method for demonstrating the adequacy of destrengthened reserves for annuities is by means of actuarial projection of the expected fund, reserve and surplus running until most of the annuities have terminated and using realistic assumptions as to future interest earnings, repayment of existing investments and benefit payments with appropriate margins for future uncertainties. In no event should the amount of destrengthening exceed the unamortized portion of the surplus strain encountered when the revalued business was originally put on the books.

2. Implication of Future Interest Rate Changes for Group Annuities

The financial effect on a company of future fluctuations in interest rates will depend on the relative proportions of immediate annuities and short-term deferred annuities to long-term deferred annuities in force.

a. Immediate Annuities

An important consideration in any reserve destrengthening is the duration to maturity or reinvestment of the underlying investments associated with the business relative to the duration to maturity of the insurer's contractual obligations. If future cash flows required by benefit payments closely parallel future cash flows generated by interest income and repayments of capital on an insurer's investments, the effect of a change in the rate of future investment earnings on the funds underlying the business should be minimal. Thus these funds tend to be immunized from any effects due to future fluctuations in investment yields. For example, in the case of most immediate annuities there is little likelihood of an appreciable change, either upward or downward, in the rate of investment earnings on suitably invested underlying funds because most interest and principal repayments are paid out in benefits rather than being reinvested.

b. Deferred Annuities

With respect to deferred annuities which are within a few years of their payout phase, the effect of reinvestment of future cash flows will be similar to that described for immediate annuities; the effect of a change in the rate of future investment earnings on the funds underlying the business should be minimal. For existing deferred annuities with longer terms to maturity, reinvestment of interest and principal repayments will have an effect whose significance will vary by the length of term to the beginning of the payout period. For a significant period into the future while new money rates exceed the portfolio rates, the rate of return on investments supporting these annuities would be expected to rise. There may be a greater likelihood of dispersion in future interest yields from high new money rates than from lower new money rates. Future yields on funds underlying deferred annuities with longer terms to maturity may fluctuate until these contracts reach their payout phase and thereby become immunized from the effects of yields on new investments. In most cases, group annuities with longer periods to maturity will constitute only a small portion of existing group annuities.

However, if in a particular company a major proportion of annuities for which reserves are to be destrengthened involve long deferral periods, such a company should be prepared to demonstrate that the destrengthened reserves will be sufficient to carry these contracts to maturity in the event of adverse trends in future interest earning and/or mortality experience.

3. Utilization of Reserves Released

A company who requests permission to destrengthen reserves should estimate the dollar amount of reserve destrengthening and should be able to show that such destrengthening would better enable it to meet its responsibilities to policyholders and the public. For example, where dividends (and/or experience credits) to group annuity policyholders have been lower than otherwise would have been credited in the absence of statutory reserve requirements, less redundant reserves would make possible a larger allocation of distributable surplus. On the other hand, if an insurer had based dividends (and/or experience credits) to group annuity policyholders on realistic experience factors and an appropriate risk reserve, then reserve destrengthening would enable the insurer to absorb surplus strains caused by writing new group annuities that they would otherwise be unable to write.

(C) Committee Technical Task Force to Review
Valuation and Nonforfeiture Value Regulation

Life Insurance

June 1977

This report concerns only the proceedings of the NAIC Technical Task Force to Review Valuation and Nonforfeiture Value Regulation since the December 1976 meeting. Recommendations requiring a decision by the National Association of Insurance Commissioners at the June 1977 meeting were sent in a "Special Report" dated May 2, 1977 to all members of the NAIC.

Report Outline

A. Proceedings

1. Progress on the Construction of New Mortality Tables.

2. Nonforfeiture Value Regulation.

    a. Revisions of the Standard Nonforfeiture Law for Life Insurance.

    b. The Individual Deferred Annuity Standard Nonforfeiture Law.

3. The Valuation of the Policy Reserve Liability.

    a. Group Annuity Deposit Administration Funds.

    b. Problems with the Recently Adopted Revisions to the Standard Valuation Law.

4. Special Problems.

5. Guidelines.

B. Recommendations

See Special Report dated May 2, 1977.

A. Proceedings

This report includes the minutes of two meetings, December 5, 1976 (Attachment A) and March 30 and 31, 1977 (Attachment B).

1. Progress on the Construction of the New Mortality Tables

    a. The basic tables are in the process of development and research is beginning concerning the margins to be added to the basic tables. Attachment C outlines some of the approaches to be made in the research and some of the other related "C" attachments offer further suggestions.

    b. The use to which the tables are to be applied must be considered and the need for related tables established. Some items to be considered are (not necessarily in order of importance):

        1. Extended Term Insurance

        2. Extra Mortality on Group Conversions

        3. Substandard Insurance Mortality Tables

4. Guaranteed Issue Experience

5. Industrial Insurance Mortality

6. Valuation Mortality vs Nonforfeiture Mortality Assumptions

7. Renewable Term Insurance

c. The form of the tables requires studying.

1. The effect on the pattern of reserves of the use of a select and ultimate table vs an aggregate table – select and ultimate tables develop higher reserves due to the steeper slope of the mortality curve.

2. The effect on the expense loadings assumed in the nonforfeiture value formulas of using the various mortality table structures mentioned above.

d. The time table projected at this time for the completion of tables is:

1. The first draft of the new tables should be available for presentation at the 1977 Annual Meeting of the Society of Actuaries and the December 1977 NAIC meeting.

2. There should be at least six months discussion, testing and modification with the preliminary results of such testing to be presented at the June 1978 NAIC meeting.

3. Final testing should be completed by the December 1978 meeting.

4. The first draft of the revised nonforfeiture law for life insurance should be presented at the June 1979 NAIC meeting.

5. The final draft should be presented for adoption by the NAIC at the December 1979 meeting.

6. This time table approximates the actual experience with the construction of previous tables.

2. Nonforfeiture Value Regulation

a. Revisions of the Standard Nonforfeiture Law for Life Insurance

1. Until the new mortality tables are constructed and tested the current draft of the law (Attachment C to the December 1976 report and Attachment D to this report) can only be changed to adjust for presently noted inconsistencies (Attachments E through E-4).

2. The technical task force is having considerable difficulty devising workable language to eliminate the need for literal compliance to the standard nonforfeiture law. Implicit in the elimination of such need is the establishment of some permanent body to review problems as they arise and draft guidelines for regulatory action. The technical task force, if aided by a panel of actuarial experts, could possibly function as such a review board.

b. The Individual Deferred Annuity Standard Nonforfeiture Law

Attachments F and F-1 indicate some problems with the recently adopted standard legislation. The technical task force will make recommendations concerning these after proper review.

3. The Valuation of the Policy Reserve Liability

   a. Group Annuity Deposit Administration Funds.

      1. A "stop-gap" guideline to the valuation of group annuity deposit administration funds is to be developed for presentation to the NAIC for adoption at the December 1977 meeting of the NAIC (Attachment G).

      2. Special enabling legislation must be developed as part of the standard valuation law.

      3. The technical task force is studying the requirement of additional investment return information in the Annual Statement Blank and the inclusion of such information in the NAIC Data Base so as to be able to set up a uniform procedure for updating interest assumptions (not only for group annuity deposit administration funds, but for all valuation purposes).

   b. Problems with the recently adopted revisions to the standard valuation law.

      1. Single Premium Life Insurance Interest Assumptions for Minimum Policy Reserves and Minimum Nonforfeiture Values. After Having previously strongly advocated that these interest assumptions were applicable at this time, the American Council of Life Insurance Companies reversed its position and recommended that the interest assumptions for single premium life insurance minimum reserves and nonforfeiture values be reduced to those recommended for annual premium life insurance. The technical task force will consider this proposed change for possible implementation when the standard nonforfeiture law is revised (in about 2½ years).

      2. Renewable Term Insurance

         (i) The 1958 CSO Mortality Table, because of its very conservative margins and because of recent dramatic improvement in mortality, is unrealistic and redundant as a basis for premium scales for renewable term plans. The result, for any insurer wishing to develop as realistic a premium scale as possible, is the generation of excessive premium deficiency reserves.

         (ii) Attachment H is a draft of one approach in solving this problem. This depends upon adopting some form of "stop-gap" mortality table for use with renewable term insurance.

      3. Premium Deficiency Reserves. The revisions to the standard valuation law adopted by the NAIC in December 1976 revised the method of calculating reserves for the situation when the valuation net annual premium exceeds the gross premium actually charged. Some guidelines appear needed and the technical task force is drafting guidelines to be presented at the December 1977 meeting of the NAIC.

4. Special Problems

   a. Deposit Term Insurance

      1. The revisions to the standard nonforfeiture law will alleviate some of the current regulatory problems concerning deposit term insurance. There has been some discussion of this (Attachments I through I-5).

      2. Attachment J offers some further illustrations of the effect of the legislation recommended by the Special Society of Actuaries Committee on Valuation and Nonforfeiture Value Law.

   b. Interest Assumption Variation by Issue Age (see Attachment K). The task force must discuss and resolve this problem.

   c. Mortality Fluctuation Reserve (see Attachment L). The task force must discuss this problem. Considerably more research is indicated.

5. Guidelines

   a. The technical task force is in the process of drafting a number of guidelines for valuation and nonforfeiture value regulation which eventually will be included as part of the Examiner's Handbook published by the NAIC.

   b. The December 1977 report of the technical task force should present some of these for transmittal to the (A2) Subcommittee for inclusion in the handbook.

   c. Contemplated at this time are guidelines for:

      1. A "stop-gap" method of valuing group annuity deposit administration funds.

      2. The valuation of policies whose valuation net premiums exceed the actual gross premium collected.

      3. Deposit term insurance.

      4. The valuation of renewable term policies.

      5. A "stop-gap" method for the valuation of substandard insurance.

      6. The valuation and nonforfeiture value regulation of "life cycle," "indexed" and other various forms of unscheduled life insurance plans.

B. Recommendations

See Special Report dated May 2, 1977.

John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; William A. White, New Jersey; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah; Bradford S. Gile, Wisconsin.

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Index to Attachments to June 1977 Report

Attachment	Subject	
	Nonforfeiture Law Draft	
D	3/23/77	Suggested Modifications by American Council of Life Insurance Companies
D-1	3/30/77	Letter, A. Richards to J. Montgomery
E	2/22/77	Letter, S. Koppel to J. Montgomery
		Problems With Slope of Cash Value Scale and With Guaranteed Unscheduled Changes
E-1	3/10/77	Letter, B. Gile to J. Montgomery
E-2	3/11/77	C.F.B. Richardson to J. O. Montgomery
E-3	3/11/77	Report by H. Leff
E-4	3/17/77	Report by J. R. Scher
	Nonforfeiture Law for Individual Deferred Annuities	
F	2/14/77	Letter, W. K. Sloan to J. O. Montgomery
		-- Various Topics
F-1	3/31/77	Letter, H. H. Kayton to J. O. Montgomery
		-- Terminally Loaded Contracts
	Policy Reserve Valuation	
G	4/15/77	Draft on Group Annuity Deposit Administration Funds
H	Renewable Term Discussion Draft Prepared by ACLIC	
	Deposit Term	
I	Nonforfeiture Values and Commissions	
	1/5/77	A. C. Gill to B. A. Halstead Jr.
I-1	10/26/76	B. A. Halstead Jr. to J. O. Montgomery
I-2	7/7/76	B. W. Baucom to A. C. Gill
I-3	7/2/76	B. A. Halstead Jr. to B. W. Baucom
I-4	6/23/76	B. W. Baucom to B. A. Halstead Jr.
I-5	6/11/76	B. A. Halstead Jr. to H. Unruh
J	Illustrations of Values	
	5/2/77	Report by H. Leff
	Other Items	
K	Discriminatory Practices by Age	
	3/17/77	Letter, J. R. Estefania to J. O. Montgomery
L	Mortality Fluctuation Reserve	
	3/16/77	Letter, W. K. Sloan to J. O. Montgomery
M	Interest Assumptions, Mortality Table Constructions (Two unrelated topics in one letter)	
	4/25/77	Letter, W. A. White to J. O. Montgomery
N	Group Annuities Reserve Destrengthening, ACLI Memo	
	Proposed Destrengthening Guidelines by ACLI	

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ATTACHMENT A

(C) Committee Technical Task Force on
Valuation and Nonforfeiture Value Regulation

Phoenix, Arizona
December 5, 1976

The NAIC (C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation met from 9:00 a.m. until 6:00 p.m. on December 5, 1976 in the Board Room of the Hyatt Regency Hotel in Phoenix, Arizona.

Present at the meeting were: For the NAIC Technical Task Force: John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James R. Montgomery III, District of Columbia; Erma Edwards, Nevada; Thomas J. Kelly, New York; William R. Burns, North Dakota; J. Ramon Estefania, South Carolina; LaMar Walker, Utah; Bradford S. Gile, Wisconsin. Another state insurance department representative attending was Larry Gorski, Illinois.

Representing the Society of Actuaries Special Committee on Nonforfeiture Value Regulation were: Adrian Gill, Chairman, from Mutual of New York; Charles Greely from Metropolitan Life Insurance Co.; Richard Miller, from Southwestern Life Insurance Co.

Representing the American Council of Life Insurance were:e Richard Minck and John K. Booth.

Representing the Technical Advisory Committee on Variable Products was Jerome Golden of Equitable Variable Life Insurance Company, Chairman of that committee.

Other persons present at this meeting were: David M. Holland for Munich American Resurance Co. and Carl R. Ohman for Equitable Life Assurance Society. For Milliman and Robertson, Consulting Actuarial firm Howard Kayton and Gerald T. Coger.

For Teachers Insurance and Annuity Association J. Paul Quinn and Tom Walsh. For Anchor National Life Insurance Company Greg Carney and Carroll Dietle.

A brief summary of the discussion follows, not in the order they occurred, but in order by NAIC subcommittee material.

(C3) Life Insurance Subcommittee

1. The contents of the special recommendations presented November 4, 1976, additional attachments to those special recommendations sent November 15, 1976, and the routine report to be presented to the NAIC at the December 1976 meeting were discussed and some changes were made:

a. After much debate the technical task force decided to present Recommendation 3 (the retroactive change in valuation interest assumptions for group annuity reserves from 3½% to 5%) to the (C3) Subcommittee.

b. If Recommendation 3 of the special recommendation is adopted, or, if it is not adopted at the 1976 session, before the recommendation is proposed again, certain guidelines, or perhaps even model regulations, are needed covering such features as:

   1. Specification or reiteration of the right of the regulatory authority to require approval by such authority before any change in reserve basis is permitted.

   2. Requiring an exposition of the source for the surplus to be released. Is the surplus to be released derived from the policyholders' contributions, the insurer's investment in the business, or both?

   3. A demonstration of how the surplus is to be released:

      (i) When a refund is made directly to the policyholder.

      (ii) When the surplus released is to be used to finance new business.

4. Restrictions on the amount of surplus which can be released during a specified period such as a year.

c. Remove the 1990 limit on the 7½ percent valuation interest assumption in the revision of the standard valuation law (Recommendation 2). There was also considerable discussion on the appropriateness of the 7½ assumption for the valuation of immediate annuities.

2. The draft of the proposed revisions of the NAIC Standard Nonforfeiture Law prepared by the American Council of Life Insurers was discussed:

Section 2(a) There was agreement on the concept of the change in wording proposed but some difference of opinion as to whether the wording proposed was completely appropriate. The wording, in addition to specifying a guaranteed paid-up nonforfeiture benefit also added:

> In lieu of any guaranteed paid-up nonforfeiture benefit the company may substitute an actuarially equivalent paid-up nonforfeiture benefit which provides a greater death benefit or longer period of death benefit.

> What does "actuarially equivalent" mean?

Section 2(e) There was considerable discussion as to which types of contracts should require tables of nonforfeiture values to be included in the contract and which should require such tables to be furnished only upon request of the policyholder. This may require a definition of plans to which the special treatment for flexibility should apply and a definition of the nature of that special treatment.

Section 3 The proposed wording should be simplified by separating references to term riders from references to family plan benefits.

Section 5C

(1) Section 5-C appears long enough to require subsections or subdivisions of the section.

(2) The purpose of considering the policy fee is to relieve the requirement of separate scales of nonforfeiture values depending upon the amount insured. In limiting the policy fee exclusion to $30 in the formula for the adjusted premium the variation by amount insured would only exist for those plans with actual policy fees considerably in excess of that $30 limitation. There was considerable discussion as to the need for a limit on the policy fee exclusion. This is an area yet to be resolved by the technical task force.

(3) It was noted in the first paragraph by basing excess initial expense allowances on levelized net premiums rather than the first year adjusted premium, that if renewable term insurance is considered continuous, the triviality test will throw out cash values and generate a higher expense allowance.

(4) The third and fourth paragraphs of this section concerning flexible plans needs to be reorganized either into smaller paragraphs or into subparagraphs.

(5) There was discussion as to whether the statute should only present basic principles which would then be implemented by regulations, or whether it should be specific. It was decided by the technical task force (5 for specific statute, 1 for general statute and 1 abstention) to make the statute specific.

(6) Industrial life might have a separate formula based on small average size (elimination of policy fee reduction?).

(7) In the fifth paragraph the interest assumptions recommended should be verified by a confidential survey of the interest assumptions actually made by the various insurers for profit testing purposes. It was suggested that such a study be made in conjunction with the adoption of a new mortality basis.

Section 6 Members of the task force expressed grave doubts about the inclusion of this section in the recommendation and decided that this section, if recommended at all, would be made the subject of a separate recommendation. This is the section giving the commissioner the right to waive certain requirements as long as the benefits under the policy are substantially as favorable to the policyholders and insureds as the minimum benefits otherwise required and that the benefit structure of the contract is not such as to mislead prospective policyholders or insureds.

Section 7 (Formerly 6) The task force must decide whether the statute should define only one set of minimum values or several sets based on assumptions as to how premiums are paid or ages determined.

Section 8 (Formerly 7) The technical task force agreed to the twenty year, age seventy-one limits in defining contracts requiring no guaranteed nonforfieture values. With respect to the 2½% rule on testing triviality, further checking needs to be done to verify.

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ATTACHMENT B

(C) Committee Technical Task Force on
Valuation and Nonforfeiture Value Regulation

San Francisco, California
March 30-31, 1977

The NAIC (C) Life and Accident and Health Insurance Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation met on March 30 and 31, 1977 at the office of the California Insurance Department in San Francisco, California.

Present at these meetings were: For the technical task force (all members attended both days): John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; Erma Edwards, Nevada; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah.

Members of the task force not attending were: James Montgomery III, District of Columbia; William White, New Jersey; William R. Burns, North Dakota; Bradford S. Gile, Wisconsin.

Other state insurance department personnel attending were Richard W. Bean and Eugene E. Jacks from the California Department.

Representing the American Council of Life Insurance were Richard V. Minck (for the sessions involving life insurance only) and John K. Booth (for all sessions).

Representing the Health Insurance Association of America was Peter Thexton (March 31 meeting only).

Representing the Society of Actuaries' Special Committee on Nonforfeiture Value Regulation were: Charles Greely and Harold B. Leff, Metropolitan Life, for all sessions (Mr. Leff will represent Mr. Greely at the June 1977 task force meeting); Richard D. Miller, Southwestern Life (for all sessions); Alan Richards, Life Insurance Co. of California (March 30 meeting only).

Representing the Society of Actuaries' Special Committee on the Construction of New Standard Ordinary Mortality Table was Wilbur Bolton, Occidental Life (March 30 meeting only).

Representing the NAIC Technical Advisory Committee on the Construction of Credit Disability Claim Cost Tables was Ken Jones, CUNA Mutual (March 31 only).

Representing the NAIC Technical Advisory Committee on the Valuation of Health Insurance Contracts was E. Paul Barnhart, Consultant (March 31 meeting only).

Representing the NAIC Technical Advisory Committee on Valuation and Nonforfeiture Value Regulation for Variable Products was Thomas Walsh, Teachers Insurance and Annuity Association (March 31 only).

Other persons attending were Robert A. Miller III, Aetna Life and Casualty (March 30 meeting only); Richard M. Stenson, Equitable Life Insurance Co. of New York (March 30 meeting only); Gregg Carney, Anchor National Life Insurance Co. (March 31 meeting only).

Change in NAIC Technical Task Force Membership

William R. Burns of the North Dakota Department has resigned from the NAIC technical task force and we will miss his many fine comments. I will continue to send Bill copies of the NAIC task force communications and if he is able we would appreciate any comments he might wish to make. Larry Gorski of the Illinois Department replaces Bill on the task force. The membership of the technical task force now consists of: John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; William A. White, New Jersey; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah; Bradford S. Gile, Wisconsin.

Items for the (C3) Life Subcommittee

Special Nonagenda Item

Mr. Robert A. Miller III, Vice President and Actuary of the Aetna Life and Casualty Company made a plea to reduce the maximum permissible interest rate for the valuation of single premium life insurance and endowment policies from the 5½% adopted in December 1976 by the NAIC to 4½%, and the corresponding maximum permissible interest rate for determining nonforfeiture values on single premium plans from 6½% to 5½%. Arguments advanced by Richard Minck of the American Council of Life Insurance and reiterated by Mr. Miller were:

(1) There is a possibility that the possibility of asset loss has not been thoroughly explored (this is a complete reversal of the Council's views in convincing the NAIC task force last year that such higher interest assumptions for single premium life and endowment contracts were appropriate).

(2) The 5½% rate for reserves and 6½% of rate for cash values for single premium plans might lead some smaller companies to set premium rates too low.

(3) The higher interest assumptions might lead to widespread replacement of existing in-force policies. A solution would be an increase in paid-up life insurance on existing policies, without higher cash values.

John Montgomery observed that the action of the American Council of Life Insurance was a total reversal of its stand last year when the Council strongly advocated that the 5½% minimum valuation and 6½% minimum nonforfeiture value interest assumptions were appropriate for single premium life and endowment contracts after the task force had expressed some misgivings on going to the higher interest assumptions.

In executive session it was moved and agreed unanimously to reject at this time the proposal of the American Council of Life Insurance to recommend to the NAIC that interest assumptions adopted in December 1976 for single premium life and endowment policies be reduced by one percentage point. The matter of the interest assumptions for single premium life insurance and endowment policies will be reviewed by the NAIC technical task force for possible implementation when the new standard ordinary mortality tables and the revisions to the formula to calculate nonforfeiture values are ready to be presented to the NAIC in the form of model legislation. In the meanwhile evidence of the problems predicted (massive replacements, inadequate premium rates, etc.) will be sought for.

The members of the technical task force were also unanimous in the view that proposals to the task force should not be subject to capricious changes after such proposals are once submitted to the task force.

Agenda Items 1 and 2 Revisions to the Standard Nonforfeiture Law

The original agenda, prepared February 11, 1977, had scheduled two items concerning standard nonforfeiture law revisions:

Item 1 – Preparation of Final Draft Revisions.

Item 2 – Discussion of Report to Accompany Such Final Draft.

The revisions to the standard nonforfeiture law must be delayed until all of the remaining components such as mortality tables and expense formulas can be resolved. A target date of December 1978 has been set for the final proposal for revision of the standard nonforfeiture law.

Suggested modifications in the proposed revisions in the NAIC standard nonforfeiture law as attached to the NAIC (C3) Subcommittee report in December 1976, were submitted by John Booth of the American Council of Life Insurance in a draft dated 3/23/77 (Attachment D). Points raised in the discussion of the suggested modifications were:

(1) Section 2(a) still needs more work although the NAIC technical task force agrees with the concept that, in lieu of the paid-up nonforfieture benefit stipulated in the policy, an actuarially equivalent alternative paid-up nonforfeiture benefit may be substituted by the insurer which provides for a greater amount of death benefit and/or endowment benefit (if applicable), and/or a longer period of term insurance or endowment.

(2) The modification of section 2(e) suggested by ACLIC was further modified in the first sentence to read (new wording underlined).

> In the case of policies which provide for guaranteed unscheduled changes in benefits or premiums, other than a change to a new plan of insurance or to a new policy, or which provide an option to change future benefits or premiums, a statement of the mortality table, interest rate, and method used in calculating cash surrender values and the paid-up nonforfeiture benefits available under the policy.

(3) The suggested revision of Section 3 was accepted without much comment.

(4) With respect to the suggestion concerning Section 5-C the unlimited exclusion of "any annual contract charge or policy fee inherent in such premiums" the NAIC task force agreed that such an exclusion should be allowed only for a charge or fee not varying by policy duration.

(5) Since the third paragraph of Section 5-C refers to unscheduled change the wording of that section has been revised to insert "unscheduled" where appropriate. It was observed that the use of mathematical formulas would greatly facilitate the understanding of the complex wording of this section.

(6) The revisions suggested in proposal 6 of the ACLIC draft were in response to certain criticisms in Spencer Koppel's letter of February 22, 1977 (Attachment E). Mr. Koppel had noted two situations arising with the proposed revision of the standard nonforfeiture law:

(a) Cash values in the early durations began decreasing with advancing issue age.

(b) The increased expense allowance permitted for policies which provide for guaranteed unscheduled changes in benefits and premiums, at the time of change to newly defined benefits or premiums would, under the form of legislation proposed in the draft presented in December 1976, result in an increment in the cash value associated with the change which in almost every instance would be less than the cash value an insured could obtain by simply buying a new policy with identical changes in benefits.

Proposal 6 attempted to resolve the second of these two criticisms. Some wording was added at the meeting and the NAIC technical task force generally agreed that the concept seemed appropriate. However the wording is quite complex and may need further refinement.

(7) The reduction in minimum nonforfeiture value interest rate for single premium life policies to 5½% is proposed under proposal 7. The NAIC technical task force is not willing to consider this reduction until it can be demonstrated to the satisfaction of the NAIC technical task force that such reduction is truly needed.

(8) Proposal 8 redefines the term plans which need not provide nonforfeiture values, extending the criteria for such exceptions from the present fifteen year limit to a twenty year limit and from the present age 66 limit to an age 71 limit.

Retention of Section 6, Elimination of the Need for Literal Compliance to the Standard Nonforfeiture Law.

Section 6 gives the commissioner broad discretionary authority to approve policy forms in the public interest, even if they do not need the literal requirements of the law. Alan Richards (Attachment D-1) made a strong plea for the retention of this section.

The NAIC technical task force cannot accept Section 6 in its present form because it is administratively unworkable. It was suggested that the application of such discretionary authority should be allowed only for those policies or plans not contemplated in any way by the current model law. It was suggested again that the NAIC technical task force should become a permanent technical subcommittee of the (C) Committee so that it can consider new problems as they arise, draft guidelines to accommodate those problems and propose model legislation if that appears needed. This technical subcommittee would develop an advisory panel of actuarial experts from which it could draw on for technical assistance.

Agenda Item 3 – Guidelines to Accompany Recommendation 3 of the Special Report of November 1976 to the (C3) Life Subcommittee

These guidelines were discussed and the final form appears in the special report to the (C3) Life Subcommittee dated May 2, 1977.

Agenda Item 4 – The Valuation of Group Annuity Deposit Administration Funds

1. It was agreed to attempt to devise a "stop-gap" guideline to the valuation of group annuity deposit administration funds for presentation for adoption by the NAIC at its December 1977 meeting.

2. The method of updating of the interest assumptions required for such valuations should be reviewed by the NAIC technical task force and a uniform procedure should be established.

3. A discussion of whether or not to require the reporting in the annual statement blank of the rate of return expected at the time a new investment is purchased evoked comments that some insurers might not want to report such information openly and that those companies not using the "new money" or "investment year approach" might raise vigorous objections to such superfluous (to them) record keeping.

   (Note: The development of valuation statutes without specified interest rates in such statutes may ultimately require annual statement disclosure of initial yields expected on new investments purchased during the year including all forms of investments such as bonds, stocks, real estate, mortgage loans; if not on each separate investment at least on each major class of new investment).

Agenda Item 5 -- Commissioners Standard Ordinary Mortality Tables

1. Wilbur Bolton, a member of the Special Society of Actuaries' Committee to Construct New Mortality Tables for Valuation, commented on the work of that committee.

2. The discussions resulted in the drafting of a letter sent April 22, 1977 to Charles A. Ormsby, Chairman of the special society committee (Attachment C).

3. In addition to the matters mentioned in the April 22 letter, several other items were either discussed at the meeting or brought to the attention of the chairman by phone at the time of the meeting by members who could not attend.

   (a) With respect to industrial insurance:

      (1) Is there really a significant difference in mortality experience between industrial and ordinary policyholders?

      (2) The commissioners ordinary tables developed may be appropriate now for the valuation of industrial contracts.

      (3) Separate industrial mortality tables for the determination of nonforfeiture values may not be needed if the formula for the calculation of nonforfeiture values on industrial policies is appropriately constructed.

   (b) The function of the special society committee is to construct a mortality table which will cover regional differences and random fluctuations and serve as a basis for minimum reserves and possibly minimum nonforfeiture values. All other considerations are outside the scope of the assignment to the special society committee. Therefore the NAIC technical task force may need to seek answers elsewhere for some of the questions asked of the special society committee.

   (c) The priority of the various projects will be established after consultation with the special society committee.

4. The NAIC technical task force must decide:

   (a) The purposes for which the standard ordinary mortality tables are to be used.

      (1) For both valuation and nonforfeiture values?

      (2) Standard ordinary underwritten issues only?

      (3) For industrial as well as ordinary insurance?

      (4) For all plans or just certain plans?

   (b) The need for special "stop-gap" adaptions for:

      (1) Guaranteed issue plans.

      (2) Renewable term.

      (3) Substandard issues.

   (c) The form of the table:

      (1) By sex vs. unisex.

      (2) Aggregate vs. select and ultimate vs. ultimate.

      (3) Margins contained in the tables for adverse fluctuations.

      (4) Should the table extend beyond age 100?

      (5) The method by which joint life tables are to be developed.

Agenda Item 6(a) -- Guidelines with Respect to the Valuation of Renewable Term Plans

1. A preliminary discussion draft prepared by the actuarial committee of the American Council of Life Insurance was submitted (Attachment H) at the March 30, 1977 meeting of the NAIC technical task force. A final report from the same source was promised by June.

2. The possibility of the "Stop-Gap Modern Mortality Table" for use in the valuation of renewable term plans was discussed. Such a table was developed by the Special Society of Actuaries' Committee on Valuation and Nonforfeiture Laws and published as Appendix H to the special committee's report to the Society of Actuaries dated January, 1976.

3. Discussion of this topic will be continued at the June meeting.

Agenda Item 6(b) -- Guidelines with Respect to the Valuation of Deposit Term Insurance

Illustrations were requested in addition to that presented in Appendix N of the January 1976 report of the Special Society of Actuaries' Committee on Valuation and Nonforfeiture Laws. Such illustrations should include plans with ratios of initial to renewal premiums of three to one and of ten to one (the society report had used a plan with an annual premium of $4.49 plus a $7.50 initial deposit).

Agenda Item 6(c) -- Guidelines with Respect to the Valuation of Split Life Insurance

Since model legislation has been adopted by the NAIC for the valuation of, and defining minimum nonforfeiture values for, individual deferred annuities, only the definition of valuation practices for renewable term insurance remains. This should be included in the guidelines for the valuation of renewable term insurance which are being developed (Agenda Item 6(a) above).

Agenda Item 7 – Indexed and Life Cycle Plans

Guidelines are to be prepared with respect to valuation and nonforfeiture value procedures for indexed and life cycle plans. This should be a continuing project as new products are developed. The NAIC technical task force should maintain a file on all new plans offered or contemplated. A special advisory committee may be needed, but at this time such a need has not yet been established.

Factors to be considered are:

(a) The inherent anti-selection in increasing the death benefit on an optional basis.

(b) The inherent financial anti-selection in some forms of cash value patterns and possible in some forms of benefit change rules.

(c) The effect of the options on persistency.

Agenda Item 8 – Other Matters

(a) Guidelines, model regulations, or some form of unified treatment is needed for the valuation of:

(1) Guaranteed insurability.

(2) Nondeduction for deferred fractional premiums.

(3) Immediate payment of claims.

(4) Substandard insurance.

(5) Extra mortality on group conversion.

In drafting such rules care must be taken not to make them too inflexible in the event that better methods either become available at a later time or have not been called to the attention of the task force at the time such rules are drafted.

The American Council of Life Insurers was asked to prepare a bibliography or reference booklet covering the matters referred above so that a beginning could be made in drafting such guidelines.

(b) Variation of Valuation and Nonforfeiture Value Interest Assumptions by Age at Issue.

(1) The attached letter from Ramon Estefania (Attachment K) on "Discriminatory Practice by Age" defines the practice and concludes that it constitutes an unfair discrimination by age. Many states have "unfair practice" laws under which this should be examined.

(2) Policies with different loan interest rates for different amounts of loan balance may also be discriminatory.

(3) The "Shoppers Guides" put tremendous pressure on insurers for competitive cash values for certain ages and durations.

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ATTACHMENT C

TO: Charles A. Ormsby, Senior Vice President
John Hancock Mutual Life Insurance Co.
P. O. Box 1111, Boston, Massachusetts 02217

FROM: John Montgomery, Actuary
California Insurance Department
600 South Commonwealth Avenue
Los Angeles, California 90005

DATE: April 22, 1977

RE: Construction of New Standard Ordinary Mortality Tables

The NAIC Technical Task Force to Study Valuation and Nonforfeiture Value Regulation discussed the construction of new standard ordinary mortality tables at its meeting March 30, 1977 at the San Francisco office of the California Insurance Department. In addition to the nature of margins needed in such tables to provide for adverse contingencies, items discussed related to the mortality tables included the problems of mortality assumptions to be used for policies issued on substandard risks, on a guaranteed issue basis, on renewable term insurance plans, and on joint life plans. For exploratory purposes the NAIC technical task force would like to see several different tables developed.

A. Margins to be Used in the Construction of New Standard Ordinary Mortality Tables.

1. The margins in the new tables should have as little effect as possible on the terminal reserves (not considering adjustment for, or in lieu of, premium deficiency reserves).

2. In considering the abandonment of the requirement in the margins used in the construction of the 1958 that no margin be less than 75 cents per 1,000, the NAIC technical task force would like to see three versions of each table developed:

   (a) The basic table with no margins.

   (b) A table including at least 85% of the companies.

   (c) A table including at least 95% of the companies (or as close to 95% as possible).

B. Mortality Assumptions for Special Valuation Problems.

1. Substandard Risks. The construction of a mortality table for the valuation of policies issued to substandard risks is not within the present charge of the Society of Actuaries' Special Committee on the Construction of New Standard Ordinary Mortality Tables. The possibility of the usage of some modification of the new standard ordinary mortality tables for the valuation of policies issued to substandard risks until a table based on substandard lives' experience can be developed should be explored by the society committee if possible.

2. Guaranteed Issue. Although the mortality experience on guaranteed issue plans, like that for substandard risks, is not within the present charge of the special society committee, it is possible that the NAIC technical task force might have to consider an ultimate (not aggregate) version of the standard ordinary table for the valuation of such contracts until separate experience tables are feasible. This should be considered in the construction of margins to be used in the new table.

3. Renewable Term Insurance. Again the mortality experience associated with renewable term plans is not within the present charge of the special society committee and again the NAIC technical task force may need to find some expedient procedure for using the new standard ordinary mortality tables for such purposes. This should be considered in constructing the new tables.

4. Joint Life Plans. The new standard ordinary mortality table should be makehamized if possible to facilitate the construction of joint life tables.

C. Mortality Tables Needed by the NAIC Technical Task Force for Exploratory Purposes (a maximum of 27 tables is possible)

1. Male vs. female vs. unisex.

2. Five year select and ultimate vs. ultimate* vs. aggregate.

3. Basic table with no margins vs. a table including 85% of the companies' experience vs. a table including 95% of the companies' experience,

   *NOTE: The ultimate experience table may differ from that of the ultimate portion of the 5 year select and ultimate table if the society committee believes that a five year select period is not sufficient in length to develop "true" ultimate experience.

(P.S. Some of the task force requirements were developed in our executive session not open to the public.)

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Attachment C-1

TO: Mr. John O. Montgomery, Chairman
(C) Committee Technical Task Force to Study Valuation and
Nonforfeiture Value Legislation

FROM: Charles A. Ormsby
John Hancock Mutual Life Insurance Company
200 Berkeley Street, Boston, Massachusetts 02117

DATE: April 27, 1977

RE: New Ordinary Mortality Table

We who are serving on the Society's Committee to Recommend New Mortality Tables for the Valuation of Individual Ordinary Life Insurance are indeed indebted to you for the many helpful comments in your letter of April 22 (based in large part on the discussions at the March 30 meeting of your (C) Committee of the NAIC).

As you would expect, I am sending a copy of your three-page letter to all members of the valuation committee so that they too can benefit from the deliberations of your task force.

I hope to be able to report back to you at a later date so that you will know what the reaction of the valuation committee is to your suggestions and advice.

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Attachment C-2

TO: John O. Montgomery

FROM: C. F. B. Richardson
Route 1, Box 88, Crystal River, Florida 32629

DATE: April 27, 1977

RE: Construction of New Ordinary Mortality Tables

I have given a good deal of thought to your letter to Charlie Ormsby and felt that, rather than phone you, my concerns were sufficiently substantial that I should record them in writing.

(1) The order seems illogical – suggest rearrange in order C, A, B.

(2) I believe you are asking for an unreasonable and unnecessary number of different tasks and that the result will be a maze in which you will get lost – besides the inevitable delays that would result – also the great expense involved.

(3) May I suggest the following for Section C.

1. (a) Male (b) Female (c) Unisex

How should the mix on (c) be determined? This will vary by age at entry, age attained and duration.

I recommend that these sex differentiated tables be constructed only on an ultimate basis.

2. Okey as stated, but construct these three tables only for males.

3. "85% of the companies' experience" is not clear and needs more precise definition. For example, does it mean that 15% of the companies by number with the highest mortality in the aggregate shall be excluded?

Also, why complicate this further by including the 95% category? Suggest this be eliminated.

What does "Basic Table" mean? Select, ultimate or aggregate? Suggest these two tables be constructed for male lives only.

(4) Under Section A:

1. Agree with Item 1, but the extent of tests on reserves should be defined and severely limited. Suggest that reserve be computed on ordinary life for male lives, ages 30 and 50 at entry, for durations 5, 10 and 20 on net level premium basis and perhaps at 4½%.

2. Item 2 – See comments under number (3) above.

(5) Under Section B:

1. There is an urgent need to develop a valuation table for substandard business of all kinds and the objections and problems that have been brought up should not stand in the way. A broad approach is required. Until this is done, could a study be made of the relationship between standard and substandard reserves for the important plans & ages based upon the experience of companies such as Metropolitan and Lincoln? This might form a guideline for substandard reserves pending a more complete research of the problem.

2. The last sentence is not clear. Such margins depend on the proportion of guaranteed issue, the type of business involved, which vary very greatly between companies. I believe the basic tables should be constructed on standard business excluding guaranteed issue. This class of business needs research on the proper reserves, as in 1 above.

3. Reserves on renewable term are so small that refinements might well be left to the judgment of the actuary doing the valuation. The mortality on renewal steadily increases, reaching 175% to 200 % of standard at the longer durations. Someone might be asked to undertake a paper on this.

(6) I agree with the suggestions under 4 -- Joint-Life Plans.

(7) No mention is made of extended term – it is assumed that separate tables will be required.

(8) Is there any need for new industrial tables?

Forgive such a long letter, but I was greatly concerned over the magnitude and enormous scope of what was requested and felt it would involve a prohibitive amount of work and unnecessarily delay this most urgent project. I feel very strongly that the adoption of up-to-date valuation standards is of extreme urgency in the public interest.

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Attachment C-3

TO: Mr. John O. Montgomery, Chairman
(C) Committee Technical Task Force to Study Valuation and Nonforfeiture Values

FROM: W. Keith Sloan
Arkansas Insurance Department
400 University Tower Building
Little Rock, Arkansas 72204

DATE: April 27, 1977

I do have a few very minor suggestions regarding the draft of recommendation three which you sent out on April 22.

I wonder, for example, if it would not be better to use the word "immunized" rather than the word "insulated" on pages three and four. This is because the word immunize is presently in use elsewhere to describe this particular situation and if we can avoid conflicts in terminology I think we should.

Also, on page three at the bottom I wonder if it might not be advisable to hedge just a little more by changing the word "the" to "suitably invested" so that the last sentence would read "For example, in the case of most immediate annuities there is little likelihood of an appreciable change, either upward or downward, in the rate of investment earnings on suitably invested underlying funds because most interest and principal repayments are paid out in benefits rather than being reinvested."

Finally, on page four, my textbooks show that the word meaning "capital investment" is spelled "principal" rather than "principle."

I am sure that Charlie Ormsby would suggest it but I think that it might be a good idea for us to allow the Society's special committee to use a Gompertz graduation instead of makehamizing if the former were clearly superior. Incidentally, I noticed in the last issue of The Journal of the Students Society that Germany has an interesting limit on loadings for valuation tables. According to Hawken and Killroy (JSS 21 Part 3, Page 276) "mortality for such contracts must be the German male population mortality table for the years 1960/62, modified to q_x = max (q_x + .0005, q_x +1)." This is not a recommendation but I thought it was interesting and worth passing on.

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Attachment C-4

TO: Members of Society of Actuaries' Committee to Recommend New Mortality Tables for Valuation (Messrs. Anderson, Bolton, Davidson, Hinsdale, Jones, Nicol, See, Sibigtroth, Silletto, Stewart, White and Ms. McKibbon.)

FROM: C. A. Ormsby
John Hancock Mutual Life Insurance Company
John Hancock Plaza, Boston, Massachusetts 02117

DATE: March 31, 1977

You will be interested in knowing about the progress that has been made in our efforts to obtain recent mortality data and other information needed for further development of our project.

Late last week we were able to send to Joe Sibigtroth for processing by his subcommittee the crude select and ultimate mortality tables of experience for the years 1970-75 (male, female and combined male and female), with a separation also of medical and nonmedical.

Arrangements have been made with the program committee for the Quebec and St. Louis regional meetings this spring to have a representative from Dave Silletto's subcommittee on sex distinct valuation tables to comment on this part of our assignment and to raise questions with regard to the matter of sex-distinct mortality tables for valuation so that we may benefit from the comments of those in attendance. It is our understanding that the program for our part of one of the concurrent sessions will be prepared to include a statement somewhat as follows:

> At this meeting there will be an informal disucssion of sex-distinct mortality tables for valuation and nonforfeiture purposes.

Dave Silletto tells me that Waid Davidson will represent his committee at the St. Louis meeting and Hodge Jones at the Quebec meeting. Both will present prepared remarks which will let the audience know what the subcommittee is working on and what input we would like to have from those in attendance.

I am also pleased to report that Dave and his subcommittee have already made a great deal of progress in soliciting opinions on the question of sex-distinct valuation tables from medium-sized and smaller companies by using lines of communication which we usually associate with an extensive reinsurance operation, including contact with one of the top actuarial consulting firms. The material that Dave has accumulated is, in our opinion, too voluminous to distribute to all members of the committee. However, he has agreed to send copies of this material to any member of our committee on request. Enclosed is a copy of Dave's letter to me which admirably summarizes his estensive and very successful fact-finding efforts.

We hope to be in a position to ask for a meeting of the entire committee in the near future.

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TO: Mr. Charles A. Ormsby
John Hancock Mutual Life Insurance Co.

Mr. Waid J. Davidson, Jr.
Southland Life Insurance Company

Mr. Hodge L. Jones, Sr.
Guarantee Mutual Life Company

As you may know, last fall I asked Stuart Robertson if he and his M & R associates would be willing to solicit opinions from their medium-sized and smaller company clients regarding the question of sex distinct mortality tables. Their response was tremendous and an impressive amount of material was gathered by them. Incidentally, Charlie, I have expressed my personal appreciation to Stuart for their efforts, but it might also be appropriate for you to do so on behalf of the committee.

Copies of the material they gathered are attached. I would certainly leave it to each of you to draw your own conclusions from the material, but I will also be bold enough to give you mine. I draw the following four conclusions from this extensive material:

(1) Almost all actuaries agree that the current system of using age setbacks is inappropriate. Not only does the current three year setback understate the differential, but the age setback mechanism is an approximation that would be hard to defend under attack. True mortality differentials based on separate female experience will probably be needed.

(2) Actuaries generally oppose the usage of unisex tables. Everyone agress that sex is a meaningful determinant of mortality, and to ignore that would be no more justified than ignoring age or some of the other factors that influence mortality.

(3) There is also general agreement that while premium rate differentials are clearly justified, differentials in reserves and cash values are very difficult to justify on the basis of achieving equity. Since reserves and nonforfeiture values will be the purpose of the table (or tables) that we recommend, this makes the work of our committee especially difficult.

(4) There is identifiable opposition expressed to completely separate mortality tables and the concept of completely separate rates and values by sex. Admittedly, it is a minority position, and one that tends to come from smaller companies, but the opposition is there.

As I said, I will leave it up to all of you to draw your own conclusions from this material and I would appreciate any contrary thoughts that any of you might have. Waid and Hodge, I assume that some summary remarks of these comments can serve as the basis for your discussion at the St. Louis and Quebec meetings. You can then solicit any additional comments from the floor. Charlie, I will leave it up to you as to whether or not you would like to distribute this material to the rest of the committee.

I think this is all we need to do at the moment -- let me hear from any of you if anything further seems in order.

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Attachment C-6

TO: Mr. John O. Montgomery, Chief Actuary
California Department of Insurance

FROM: Wilbur M. Bolton, Associate Actuary
Occidental Life of California
Box 2101, Los Angeles, California 90054

DATE: February 28, 1977

RE: Valuation and Nonforfeiture Value Regulation Technical Task Force

As you know, I am one of the members of the Society Committee to Recommend New Mortality Tables for Valuation (Special). The committee is generally aware that its predecessor committee, chaired by J. T. Phillips in 1954-57 developed a table using its best judgment as to statistical theory in developing margins; and then had its original recommendation bounced back by the NAIC (perhaps by the appropriate subcommittee) because the margins around age 10 were too small – apparently .75 deaths per 1,000 was the minimum margin acceptable at that time.

To follow up on an informal conversation we had at the L.A. Actuarial Club meeting in February, I am sure the society committee would appreciate an informal sounding of opinion of members of your task force on the following questions on margins (between the graduated experience table and the valuation table):

1. Is there some "minimum" margin, as an absolute quantity, acceptable to all members of your task force? (The way .75 apparently was the minimum acceptable in 1956.)

2. Is there some "minimum" margin, as a percent of the valuation table, acceptable to all members of your task force? i.e., would margins smaller than 15% of the valuation table be acceptable? Smaller than 10% (if based upon appropriate statistical tests).

3. Would a loading of the type employed in developing the 1941 CSO mortality table be acceptable to your task force? (i.e., 5% or 6% of the reciprocal of the expectation of life).

I have no specific authorization to write you on this; but I thought it might be useful to the society committee if we could get some soundings from your taks force on the matter of margins, generally.

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Attachment C-7

TO: Mr. Robert T. Jackson, President
Society of Actuaries
208 South LaSalle Street
Chicago, Illinois 60604

FROM: Dr. Eleanor J. Lewis, Assistant Commissioner
Consumer Services
New Jersey Department of Insurance

DATE: February 10, 1977

It has been called to my attention that the Society of Actuaries has formed a committee to establish new valuation tables for use by life insurance companies. Valuation tables are used to determine life insurance rates and are based upon mortality data. The current tables were developed in 1956 for use beginning in 1958. Now there is one table used for both sexes, but because of the 6 to 7 year longer life span of women some companies give their women insureds a three year setback when determining rates. The compilation of these tables and their use have been of continuing concern to women knowledgable about sex discrimination in insurance.

Julius Vogel, Senior Vice President, Prudential Insurance Company, Boston, Massachusetts 02199, is chairman of the committee. The vice chairman is Charles A. Ormsby, Senior Vice President, John Hancock Mutual Life Insurance Company, Boston, Massachusetts 02117. The committee has 14 members -- all actuaries employed by insurance companies except for one actuary from an insurance department.

The committee is divided into two subcommittees:

Subcommittee 1 -- Chaired by Joe Sibigtroth, Senior Vice President and Chief Actuary, New York Life Insurance Company, 51 Madison Avenue, New York, New York 10010. This subcommittee is responsible for dealing with the actual assembly of experience and development and testing of the new valuations tables. The members of this subcommittee are: Kenneth P. Hinsdale -- Senior Vice President and Actuary, Jefferson Standard Life Insurance Company, Greensboro, North Carolina 27420; James G. Stewart -- Actuary, Connecticut General Life Insurance Company, Hartford, Connecticut 06152; William A. White -- Chief Actuary, Life-Health Insurance, New Jersey Insurance Department, Trenton, New Jersey 08625.

Subcommittee 2 -- Chaired by C. David Silletto, Senior Vice President, Lincoln National Life Insurance Company, Fort Wayne, Indiana 46801. It is responsible for exploring the need for separate female valuation tables, nonforfeiture values, dividend scales, etc., as distinguished from recognition of sex differences in mortality by simpler means such as age differentials or nonparticipating premium differentials. The members of this subcommittee are: Waid Davidson, Jr. -- Senior Vice President, Southland Life Insurance Company, Dallas, Texas 75221; Hodge L. Jones, Jr. -- Vice President and Actuary, Guarantee Mutual Life Insurance Company, Omaha, Nebraska 68114.

The other members of the committee are: Neil M. Anderson -- Senior Vice President and Chief Actuary--Individual Insurance, National Life Insurance Company, Nashville, Tennessee 37250; Wilbur M. Bolton -- Associate Actuary, Occidental Life Insurance Company, Los Angeles, California 90054; J. Clunas McKibbon -- Actuary, London Life Insurance Company, London, Ontario N6A 4K1; William K. Nicol -- Executive Vice President, Insurance Services, American National Insurance Company, Galveston, Texas 77550; Gary N. See -- Vice President and Actuary, Washington National Insurance Company, Evanston, Illinois 60201.

For several years women have been questioning insurance regulators and companies about industry practices which discriminate against women in life insurance. One focus of their complaints has been the lack of separate valuation tables for males and females or the lack of a single rate for both sexes. Thus the committee's work is one of great interest to these women.

Although much of the committee's work is of a technical nature, the committee will also be making decisions influenced by value judgements, philosophy, and basic concepts of equity. Further, the adoption of these new tables for mandatory use in all states and by all companies will require the joint efforts of insurance regulators, insurance companies, and state legislators.

To insure that the tables are properly prepared and rapidly adopted for mandatory use in all states, I recommend that a group of activist women concerned and knowledgeable about sex discrimination in life insurance be appointed. I will be very happy to supply you with the names of such women.

Your cooperation in promptly appointing such women to the committee will be appreciated.

Roster of Committee Members

Senator Anne C. Martindell
Princeton, New Jersey

Commissioner Lester L. Rawls
President, National Association
of Insurance Commissioners

Commissioner James J. Sheeran
Trenton, New Jersey

Ms. Barbara Brown, Esq.
Philadelphia, Pennsylvania

Former Commissioner Ark Monroe
Washington, D.C.

Prof. Sylvia Law, Esq.
New York, New York

Ms. Marie Roberts Keeney
Harrisburg, Pennsylvania

Ms. Carmella G. Lacajo
Los Angeles, California

Ms. Barbara Shack
New York, New York

Prof. Joseph Belth
Bloomington, Indiana

Mr. Michael Godby
Morristown, New Jersey

Commissioner John Ingram
Raleigh, North Carolina

Deputy Commissioner Gloria Jimenez
Raleigh, North Carolina

Prof. Ruth Bader Ginsburg, Esq.
New York, New York

Ms. Bernice Malemud
New York, New York

Commissioner Harold B. McGuffey
Chairman, National Association of
Insurance Commissioners Executive Committee

Ms. Susan Ross, Esq.
New York, New York

Prof. Wendy Sussco, Esq.
Hartford, Connecticut

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Attachment C-8

TO: Mr. John O. Montgomery, Chief Actuary
California Insurance Department

FROM: Mr. Charles A. Ormsby, Senior Vice President
John Hancock Mutual Life Insurance Company
John Hancock Place, Boston, Massachusetts 02117

DATE: January 18, 1977

You may be interested in knowing that I have succeeded Julius Vogel as chairman of the committee to look into the matter of new valuation tables for individual ordinary insurance. President Jackson of the Society has asked Julius to take on the chairmanship of a new ad hoc committee having to do with the subject of reorganization of the actuarial profession.

President Jackson of the Society and I recently discussed the question of a better title for the committee. Its official name is now: Committee to Recommend New Mortality Tables for Valuation (Special).

The purpose of this committee is to develop new mortality tables for possible adoption by appropriate authorities for valuation of individual ordinary insurance.

You may know that the committee had its first meeting last October 12. The outlook now is that it will meet again in March or April of this year to review progress reports by its subcommittees and to make further plans for reaching its goal.

I shall be glad to hear from you whenever you have any questions about the work of the committee.

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ATTACHMENT D

The American Council on Life Insurance
Suggested Modifications In the Proposed Revisions In the NAIC
Standard Nonforfeiture Law as Attached to the NAIC (C3) Subcommittee Report in December 1976

1. Change Section 2(a) on page 1 to read:

(a) That, in the event of default in any premium payment, the company will grant, upon proper request not later than sixty days after the due date of the premium in default, a paid-up nonforfeiture benefit on a plan stipulated in the policy, effective as of such due date of such <u>amount</u> [value] as may be hereinafter specified. <u>In lieu of such stipulated paid-up nonforfeiture benefit, the company may substitute an actuarially equivalent alternative paid-up nonforfeiture benefit which provides greater death or, if applicable, endowment benefits.</u>

<u>Reason</u>: To make it clear that an actuarially equivalent paid-up nonforfeiture benefit, having a greater amount or longer period of death or endowment benefits may be substituted by the company. The cash surrender values for the alternative nonforfeiture benefit would be equal to those of the guaranteed nonforfeiture benefit only at the point of election of a nonforfeiture value and would subsequently depend upon the purchase basis for granting the alternative benefit.

2. Change Section 2(e) starting on page 2 to read as follows:

(e) <u>In the case of policies which provide for guaranteed unscheduled changes in benefits or premiums or which provide an option to change future benefits or premiums, a statement of the mortality table, interest rate and method used in calculating cash surrender values and the paid-up nonforfeiture benefits available under the policy. In the case of all other policies, a</u> [A] statement of the mortality table and interest rate used in calculating the cash surrender values and the paid-up nonforfeiture benefits available under the policy, together with a table showing the cash surrender value, if any, and paid-up nonforfeiture benefit, if any, available under the policy on each policy anniversary either during the first twenty policy years or during the term of the policy, whichever is shorter, such values and benefits to be calculated upon the assumption that there are no dividends or paid-up additions credited to the policy and that there is no indebtedness to the company on the policy.

Reason: To limit the exemption from showing a table of nonforfeiture values in the policy to only those policies which have guaranteed unscheduled changes in benefits or premiums or which provide an option to change future premiums or benefits.

3. Divide the sentence which was added to Section 3 on pages 4 and 5 into two sentences to read as follows:

Provided, however, that for any policy issued on or after the operative date of Section 5c as defined therein, which provides supplemental life insurance or annuity benefits by rider or supplemental policy provision, the cash surrender value referred to in the first sentence of this section shall be an amount not less than the sum of the cash surrender value as defined in such sentence for an otherwise similar policy issued at the same age without such rider or supplemental policy provision and the cash surrender value as defined in such sentence for a policy which provides only the benefits otherwise provided by such rider or supplemental policy provision. Provided, further, that for any family policy issued on or after the operative date of Section 5c as defined therein, which defines a primary insured and provides term insurance on the life of the spouse of the primary insured expiring before the spouse's age 71, the cash surrender value referred to in the first sentence of this section shall be an amount not less than the sum of the cash surrender value as defined in such sentence for an otherwise similar policy issued at the same age without such term insurance on the life of the spouse and the cash surrender value as defined in such sentence for a policy which provides only the benefits otherwise provided by such term insurance on the life of the spouse.

Reasons: (1) To simplify the language by separating the provisions pertaining to term riders in general from those pertaining to the spouse's term insurance under a family policy.

(2) To eliminate a conflict with the third sentence of Section 5 which applies to policies prior to the effective date of Section 5c.

(3) To make it clear that cash surrender values for policies with riders and for family policies with term insurance on the spouse are determined by adding together the cash surrender values computed separately for the base policy and the rider or for the family policy without the spouse's term insurance and the family's term insurance.

4. Change the second sentence of Section 5c on page 11 to read as follows:

Except as provided in the sixth paragraph of this section or in Section 6, the adjusted premiums for any policy shall be calculated on an annual basis and shall be such uniform percentage of the respective premiums specified in the policy for each policy year, excluding amounts payable as extra premiums to cover impariments or special hazards and also excluding any annual contract charge or policy fee inherent in such premiums, that the present value, at the date of issue of the policy, of all adjusted premiums shall be equal to the sum of (i) the then present value of the future guaranteed benefits provided for by the policy; (ii) one percent of the amount of insurance, if the insurance be uniform in amount, or of the average amount of insurance at the beginning of each of the first ten policy years; and (iii) 125 percent of the nonforfeiture net level premium as hereinafter defined.

Reason: The amount of the annual policy fee or the grading of premiums by policy size has no effect on the present value of future adjusted premiums. However, unless the per policy charges inherent in the premium structure are removed before determining the uniform percentage in the adjusted premium formula, the slope of adjusted premiums and nonforfeiture values can vary slightly for policies of different sizes where premium rates vary by size and are not level by duration. There is no reason why companies should not be allowed to eliminate the full amount of per policy changes inherent in their premium structures in order to avoid having slightly different minimum nonforfeiture benefits for different sizes of policies on the same plan of insurance.

5. Rewrite the third paragraph of Section 5c starting on page 12 as follows:

In the case of policies which permit or cause, on a basis guaranteed in the policy, changes in benefits or premiums , other than a change to a new plan of insurance or to a new policy, the adjusted premiums and present values shall initially be calculated on the assumption that future benefits and premiums do not change from those stipulated at the date of issue of the policy. At the time of any change in benefits or premiums the future adjusted premiums, nonforfeiture net level premiums and present values shall be recalculated on the assumption that future benefits and premiums do not change from those stipulated by the policy immediately after the change.

Except as otherwise provided in the sixth paragraph of this section, the recalculated future adjusted premiums for any such policy shall be such uniform percentage of the respective future premiums specified in the policy for each policy year, excluding amounts payable as extra premiums to cover impariments and special hazards, and also excluding any annual contract charge or policy fee inherent in such premiums, that the present value, at the time of change to the newly defined benefits or premiums, of all such future adjusted premiums shall be equal to the excess of the sum of (i) the then present value of the then future guaranteed benefits provided for by the policy and (ii) the additional expense allowance, if any, over the then cash surrender value, if any, or present value of any paid-up nonforfeiture benefit under the policy.

The additional expense allowance, at the time of the change to the newly defined benefits or premiums, shall be the sum of (i) one percent of the excess, if positive, of the average amount of insurance at the beginning of each of the first ten policy years subsequent to the change over the average amount of insurance prior to the change at the beginning of each of the first ten policy years subsequent to the time of the most recent previous change, or, if there has been no previous change, the date of issue of the policy; and (ii) 125 percent of the increase, if positive, in the nonforfeiture net level premium.

Reasons: (1) The paragraph has been split into three paragraphs for ease in reading.

(2) Language has been added to make it clear that this recalculation procedure is not applicable to policy changes involving a change to a different policy or plan of insurance (such as attained age term conversions) but applies only to changes in benefits or premiums which are an integral part of the existing plan of insurance.

(3) The language referring to per policy changes has been changed to conform with the change in item 4 above.

(4) Language has been added to make it clear that where there is an overlap of the first ten policy years subsequent to a change to newly defined benefits and the first ten policy years subsequent to a previous change or the date of issue of the policy, the average amount of insurance to be deducted in the formula is the average computed prior to the latest change.

6. Change the sixth, formerly the fourth, paragraph of Section 5c on page 14 to read as follows:

The recalculated nonforfeiture net level premium shall be equal to the nonforfeiture net level premium applicable prior to the change increased by the present value of the increase in benefits divided by the present value of an annuity of one per annum payable at the time of the change on each subsequent anniversary of such change on or subsequent to which a premium falls due. Notwithstanding any other provisions of this section to the contrary, adjusted premiums and present values for a policy issued on a substandard basis, which provides reduced graded amounts of insurance that, in each policy year, have the same value as higher level amounts of insurance provided by an otherwise similar policy issued on a standard basis, may be calculated as if such substandard policy were issued to provide such higher amounts of insurance on the standard basis.

Reasons: (1) To eliminate double counting of the initial expense allowance when nonforfeiture values are recalculated at the time of unscheduled changes in premiums or benefits.

(2) To provide an accurate definition of the annuity of one per annum in the event the change occurs on the policy anniversary.

(3) To make it clear that the alternative treatment permitted by this sentence is available only to the traditional "graded death benefit" type of substandard policy.

7. Change the third sentence of the seventh, formerly the fifth, paragraph of Section 5c on page 14 to read as follows:

All calculations shall be made on the basis of a rate of interest of 5½ percent per annum, except that under any paid-up nonforfeiture benefit including any paid-up additions, any cash surrender value available, whether or not required by Section 2, shall be calculated on the basis of the mortality table and rate of interest used in determining the amount of such paid-up nonforfeiture benefit.

Reasons: (1) To reduce the statutory nonforfeiture interest rate for single premium life insurance from 6½% to 5½%.

(2) To simplify language.

8. Change Section 8 on pages 17 and 18 to read:

8[7]. This Act shall not apply to any reinsurance, group insurance, pure endowment, annuity or reversionary annuity contract, nor to any term policy of uniform amount, which provides no guaranteed nonforfeiture or endowment benefits, or renewal thereof, of 20 [15] years or less expiring before age 71 [66], for which uniform premiums are payable during the entire term of the policy, nor to any term policy of decreasing amount, which provides no guaranteed nonforfeiture or endowment benefits, on which each adjusted premium, calculated as specified in Sections 5, 5a, [and] 5b and 5c, is less than the adjusted premium so calculated, on a [such] term policy of uniform amount, or renewal thereof, issued at the same age and for the same initial amount of insurance[,] and for a term of 20 years or less expiring before age 71, nor to any policy, which provides no guaranteed nonforfeiture or endowment benefits, for which no cash surrender value, if any, or present value of any paid-up nonforfeiture benefit, at the beginning of any policy year, calculated as specified in Sections 3, 4, 5, 5a, 5b and 5c, exceeds 2½ percent of the amount of insurance at the beginning of the same policy year, nor to any policy which shall be delivered outside this state through an agent or other representative of the company issuing the policy. For purposes of determining the applicability of this Act, the age at expiry for a joint term life insurance policy shall be the age at expiry of the oldest life.

Reason: To clarify and simplify the language.

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TO: Mr. John O. Montgomery, F.S.A., Chairman
Task Force on Standard Nonforfeiture Law

FROM: Alan Richards, F.S.A., Chairman and President
Life Insurance Company of California
100 California Street, San Francisco, California 94111

DATE: March 30, 1977

RE: Section 6 of the Nonforfeiture Law

The purpose of this letter is to urge inclusion -- rather than separate consideration -- of Section 6 of the proposed standard nonforfeiture law in your recommendations to the National Association of Insurance Commissioners.

The purpose of Section 6 is summed up very well on page 13 of the Report of the Society of Actuaries' Special Committee on Valuation and Nonforfeiture Laws:

> We feel that the method by which nonforfeiture values are currently regulated impedes new-product development at a time when changing social and economic patterns require innovative product designs to meet the changing needs of our clients. For example, present nonforfeiture value regulations have undoubtedly hampered the development of products such as indexed and life-cycle policies.

While it is generally recognized that the existing framework for calculation of nonforfeiture values has worked reasonably well in the past, it is important to provide some mechanism whereby the interests of the consumer (and those who provide products for the consumer) can be protected against an unnecessarily rigid regulatory structure.

Section 6 permits innovative ideas not contemplated by the structure of the present law to be tested first by a regulatory body. If approved they can then be subjected to the ultimate test of the marketplace. Without this mechanism, it appears likely that we shall continue to see a decline in the relative status of individual life products in their struggle for the consumer dollar.

We need look no further than the railroads for an example of the decline of a once great industry due, at least in part, to the application of rigid regulatory formulae to its operations.

In recent years, the term "deregulation" has become the vogue. While few would suggest that nonforfeiture values be totally unregulated, nevertheless, the regulators should at least have the ability to react quickly and favorably to new ideas which could benefit the average person's search for financial security.

In summary, it would not be appropriate to sever consideration of Section 6 from the rest of the proposed standard nonforfeiture law. Section 6 provides a balance against the necessary rigidity of the other sections of the law.

Without Section 6, the basic formulas would have to be expanded to include consideration of unconventional yet desirable products which do not fit the basic mold. Not only would this make for a very cumbersone law, but it is obviously impossible to anticipate the changing needs of buyers of life insurance in the future.

The task of setting up the necessary machinery should not be an especially difficult one, and will undoubtedly receive substantial support from the actuarial profession.

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ATTACHMENT E

TO: John O. Montgomery, Chairman
Valuation and Nonforfeiture Value Regulation Task Force

FROM: Spencer Koppel, Actuary
Combined Insurance Company of America
5050 Broadway, Chicago, Illinois 60640

DATE: February 22, 1977

RE: Proposed New Nonforfeiture Benefits Formula

I have reviewed the exposure draft of the proposed new standard nonforfeiture law for life insurance, which I understand is to be submitted to the NAIC for adoption in June. My comments cover two different areas. I wish to indicate that these comments are based on my own opinion and do not necessarily reflect the opinion of Combined Insurance Company nor any other person or organization.

The first area has to do with the slope of the cash value scale that will result from the elimination of a ceiling on the amount of the initial expense allowance. I tested this effect on ordinary life policies using 1958 CSO mortality at 3 percent interest. I recognize that the proposed law contemplates a higher interest rate and perhaps a different mortality table, but I don't believe that this makes any difference in the emerging pattern of cash values.

What I found was that the cash values in the early durations began to decrease with advancing issue age, beginning around age 45. The effect carries out to later durations as the issue age gets even older. For example, the sixth year cash value for a policy issued at age 70 is lower than the sixth year cash value for a policy issued at age 65.

While I'm not sure that this would be found to be inherently wrong, if one were to do a "natural reserve" calculation, I believe that this is a departure from current practice and may require some education of the public on the part of the industry and perhaps the regulators also. I don't have the resources available to test the effects on other plans, but I would hope the NAIC or the Society of Actuaries makes extensive tests on the effects of this new computation method before giving it their final approval.

The other area of concern has to do with policies which provide for guaranteed unscheduled changes in benefits or premiums. More specifically, I'm concerned with the increased expense allowance permitted at the time of change to newly defined benefits or premiums. Having worked out a few examples, I've concluded that the increment in the cash value associated with the change will, I believe, in almost every instance be less than the cash value an insured could obtain by simply buying a new policy with identical changes in benefits.

Here I'm not only referring to the fact that the cash value on the total policy according to the method of calculation would decrease as a result of the change, although this is a problem also. What I'm referring to is that the increased expense allowance is based on the new nonforfeiture net premium, which in turn is based on the present value of future benefits, less the then cash surrender value, if any.

Since this cash value is based on a previously existing adjusted premium which already has an expense allowance built in, it seems to me that the formula gives rise to some double-counting of the initial expense allowance. In effect, in cases such as this, the result of the exposure draft method is to consider that the insured has placed his original insurance in a paid-up status using the cash value and purchasing a new policy for the difference in face amount. This hardly seems fair in cases where he is increasing both benefits and premiums.

I believe this could be resolved without double-counting the initial expense allowance by having the recalculated nonforfeiture net level premium be equal to the excess at the time of change to the newly defined benefits or premiums of the present value of the then future guaranteed benefits provided for by the policy over the then "reserve" under the policy, using as the net premium for the reserve the nonforfeiture net level premium in effect just prior to the change.

An example of what I'm trying to do is shown in the attached exhibit. You'll note that this method has, in the case of an increased benefit and premium, the advantage of conforming to what I would call the separation principle. That is, that the cash value on the increment is identical with the cash value that an individual could obtain from buying a new policy. It seems to me that this is the minimum increment that an individual ought to obtain, since by affecting the change in a single policy, the company may not be required to absorb as much per policy expenses when the change is made to an existing policy.

There are less clear examples, where only benefits or premiums are increased, but not both. In my view, in any case where the nonforfeiture net level premium for a changed policy is greater than the previous net level premium, the proposed method should be used. Where the nonforfeiture net level premium is reduced as a result of the change, a method which is based on a partial surrender of the original policy, such as the exposure draft method, is then appropriate.

As I indicated previously, I do have some concern that the formula as given would result in a decrease in total cash values for the policy following the change as a result of the additional expense allowance. As indicated in the Report on Actuarial Principles and Practical Problems with Regard to the Nonforfeiture Requirements prepared by the Society of Actuaries Special Committee on Valuation and Nonforfeiture Laws, published in January of 1976, it would be difficult to explain to a policyholder who has increased his premiums that his cash value has decreased. Their conclusion was that "an inability to elect such costs on those terminating short-16 after a change would mean increased costs for continuing policyholders."

This has always been a burden to insurance companies where policyholders have terminated in the early policy years when, in fact, the cash value computed according to the standard nonforfeiture law was negative, or, more theoretically, the asset share was less than the cash value. Furthermore, a policyholder who has kept a policy for several years and is now changing it by increasing the face amount or premiums or both is more likely to persist than a brand new policyholder.

I, therefore, still find it hard to justify, as I indicated to the Society of Actuaries' committee in previous correspondence, this permission given to companies to decrease the cash value at the time an increment to the benefit or premiums is made.

Mr. Montgomery, I hope my comments have been helpful to you in your deliberations as to the appropriateness of a new nonforfeiture benefit scale.

If there is anything more I can do for you, please let me know.

Call

P_x^A = Initial adjusted premium.

$P^{1A}_{x,\,x+t}$ = Recalculated adjusted premium for change at time t.

P_x^{NF} = Initial nonforfeiture net level premium.

$P^{1NF}_{x,\,x+t}$ = Recalculated nonforfieture net level premium for change at time t.

${}_tCV_x$ = Cash value of policy at time t using P_x^A prospectively.

${}_tV_x$ = "Reserve" of policy at time t using P_x^{NF} prospectively.

${}_1E_x$ = Initial expense allowance on policy.

${}_1E^1_{x,\,x+t}$ = Additional expense allowance at time t as result of change.

1958 CSO 3%

1. $1,000 Ordinary Life Policy Issued at Age 35.

Nonforfeiture Net Level Premium $P^{NF}_{35} = 1000A_{35} \Big/ \ddot{a}_{35} = 16.28858$

Adjusted Premium $P^{A}_{35} = \dfrac{1000A_{35} + 10 + 1.25\,P^{NF}_{35}}{\ddot{a}_{35}} = 17.66741$

Initial expense allowance, ${}_1E_{35} = 10 + 1.25\,P^{NF}_{35} = 30.36073$

2. $1,000 Ordinary Life Policy Issued at Age 30 Increases to a $2,000 Ordinary Life Policy at Age 35.

(a) Exposure Draft Method.

Initial Nonforfeiture Net Level Premium $P^{NF}_{30} = 1000A_{30} \Big/ \ddot{a}_{30} = 13.46754$

Initial Adjusted Premium $P^{A}_{30} = \dfrac{1000A_{30} + 10 + 1.25\,P_{30}}{\ddot{a}_{30}} = 14.61052$

Initial Expense Allowance ${}_1E_{30} = 10 + 1.25\,P^{NF}_{30} = 26.83443$

At time of increase:

Recalculated Nonforfeiture Net Level Premium $P^{1NF}_{30,\,35} = \dfrac{2000A_{35} - {}_5CV_{30}}{\ddot{a}_{35}} = 30.89910$

Note, $P^{1NF}_{30,\,35} = P^{NF}_{35} + P^{A}_{30}$ since $\dfrac{2000A_{35} - {}_5CV_{30}}{\ddot{a}_{35}} = \dfrac{1000A_{35} + P^{A}_{30}\,\ddot{a}_{35}}{\ddot{a}_{35}}$

Recalculated Adjusted Premium $P^{1A}_{30,\,35} = \dfrac{2000A_{35} + 10 + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) - {}_5CV_{30}}{\ddot{a}_{35}}$

$= P^{NF}_{35} + P^{A}_{30} + \dfrac{10 + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right)}{\ddot{a}_{35}} = 32.34281$

Additional Expense Allowance ${}_1E^{1}_{30,\,35} = 10 + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) = 31.78945$

(b) Method based on "reserve" using prior nonforfeiture net level premium.

Original premiums and expense allowance at issue are identical under both methods, a and b, i.e.

$P^{NF}_{30} = 13.46754$

$P^{A}_{30} = 14.61052$

${}_1E_{30} = 26.83443$

At time of increase:

Recalculated nonforfeiture net level premium $P^{1NF}_{30,\,35} = \dfrac{2000A_{35} - {}_5V_{30}}{\ddot{a}_{35}} = 29.75612$

Note, $P^{1NF}_{30,\,35} = P^{NF}_{35} + P^{NF}_{30}$ since $\dfrac{2000A_{35} - {}_5V_{30}}{\ddot{a}_{35}} = \dfrac{1000A_{35} + P^{NF}_{30}\,\ddot{a}_{35}}{\ddot{a}_{35}}$

Recalculated Adjusted Premium $P^{1A}_{30,\,35} = \dfrac{2000A_{35} + 10 + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) - {}_5CV_{30}}{\ddot{a}_{35}}$

$= P^{NF}_{35} + P^{A}_{30} + \dfrac{10 + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right)}{\ddot{a}_{35}} = P^{A}_{30} + P^{A}_{35} = 32.27793$

${}_1E^{1}_{30,\,35} = 10 + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) = 30.36073 = {}_1E_{35}$

3. $1,000 Ordinary Life Policy issued at age 30 changed to an endowment at age 65 at insureds age 35 with same face amount.

(a) Exposure draft method.

Original premiums and expense allowance at issue are identical under both methods and as before

$P^{NF}_{30} = 13.46754$

$P^{A}_{30} = 14.61052$

${}_1E_{30} = 26.83443$

At time of change:

Recalculated nonforfeiture net level premium $P^{1NF}_{30,\,35} = \dfrac{1000A_{35:\overline{30|}} - {}_5CV_{30}}{\ddot{a}_{35:\overline{30|}}} = 22.00397$

Recalculated Adjusted Premium $P^{1A}_{30,\,35}$

$= \dfrac{1000A_{35:\overline{30|}} + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) - {}_5CV_{30}}{\ddot{a}_{35:\overline{30|}}} = 22.57049$

Additional Expense Allowance ${}_1E^{1}_{30,\,35} = 1.25 \quad P^{1NF}_{30,\,35} - P^{NF}_{30} = 10.67054$

(b) Method based on "reserve" using prior nonforfeiture net premium.

At time of change:

Recalculated nonforfeiture net level premium $P^{1NF}_{30,\,35} = \dfrac{1000A_{35:\overline{30}|} - {}_5V_{30}}{\ddot{a}_{35:30}} = 20.66777$

Recalculated Adjusted Premium $P^{1A}_{30,\,35} = \dfrac{1000A_{35:\overline{30}|} + 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) - {}_5CV_{30}}{\ddot{a}_{35:30}} = 22.48181$

Additional Expense Allowance ${}_1E^{1}_{30,\,35} = 1.25\left(P^{1NF}_{30,\,35} - P^{NF}_{30}\right) = 11.26784$

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Attachment E-1

TO: Mr. John O. Montgomery, Chairman
NAIC (C) Committee Task Force on Valuation and Nonforfeiture Value Regulation

FROM: Bradford S. Gile, Actuary
Wisconsin Insurance Department
123 West Washington, Madison, Wisconsin 53702

DATE: March 10, 1977

RE: Spencer Koppel Letter

I very much regret that I will be unable to attend the meeting in San Francisco on March 30. However, I would like to enter my comments on the first area in Mr. Koppel's letter of February 22, 1977. I intend to enter my thoughts on the second item of Mr. Koppel's letter in a separate letter.

His first area of concern is that the revised expense allowance of $10 plus 125% of net level premium leads to an apparent anomaly in which early cash values actually decrease with issue age (beginning at age 45 using 1958 CSO mortality and 3% interest). The current allowance does this at duration one (where values are negative) but is prevented from carrying this further due to (1) the heavy influence of the $20 fixed component and (2) the arbitrary maximum allowance of $46 per thousand of insurance.

Attached are illustrative calculations which seem to support Mr. Koppel's implication that the use of a modern table with a higher interest rate will not erase this affect (on male lives). What is particularly interesting, however, is the effect of using unloaded 1965 – 70 basic ultimate female mortality table. Not only is the anomaly erased, but these female values actually surpass those of male (on the unloaded male table) somewhere between issue age 50 and 55! I believe this is an anomalous result which arises from the fact that the excess of ultimate over select mortality is much larger for males than females. Thus, if unloaded male values represent select asset shares somewhat faithfully, the unloaded female values are unlikely to produce a faithful representation of select asset shares on females.

It appears to me that we have two problems here. The first is the effect of the proposed expense allowance on the emergence of cash values. I think we have to recognize this allowance is highly approximate in nature, as evidenced by the wide variation in the estimates in the Society's report. Changes can be made in the dollar component (upward) and in the percentage component (downward) so that the resulting minimum values are only slightly changed at the bulk of issue ages but which would erase this anomaly on male issues. I think with sufficient experimentation, this problem (if it is a problem) can be solved.

We are, I think, faced with a second problem which is more serious both on theoretical and political grounds. First, the way in which the female table is loaded for nonforfeiture values will, I think, have a profound impact on the resulting female values. Second, the use of a mutually consistent expense formula between males and females can (as shown by the unloaded table illustration) produce results which are perhaps undesirable.

Thus, if we go ahead and derive an expense allowance based on the CSO table we will probably find ourselves in a box when we come up with separate male and female mortality tables for nonforfeiture values. Accordingly, I strongly suggest that the development of any modification of the current expense factor be done concurrently with the development of the separate mortality tables for males and females. As a side comment on the construction of such tables, I am not at all convinced that the loadings appropriate for a valuation table are also appropriate for nonforfeiture purposes.

I regret that I will be unable to participate in a personal interchange on this and other agenda items. I would, however, certainly welcome any comments from others.

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Progression of Whole Life Cash Values
Expense = $10 + 125% Net Level Premium
1958 CSO (ALB) at 4%

	Cash Value by Duration			
Issue Age	1	3	5	20
25	−13.72	+3.13	21.26	200.56
35	−15.19	11.13	38.87	285.56
45	−19.55	18.99	58.80	378.94
50	−23.60	22.38	69.34	423.81
55	−29.64	24.86	79.72	464.13
60	−38.73	25.00	88.12	502.62
65	−52.40	20.47	90.55	531.20
70	−73.32	7.71	86.73	561.93

Progression of Whole Life Cash Values
Expense = $10 + 125% Net Level Premium
1965-70 Basic Ultimate Male at 4% (ALB)

	Cash Value by Duration			
Issue Age	1	3	5	20
25	−12.61	3.16	20.11	189.62
35	−13.75	10.89	36.94	272.54
45	−17.35	19.12	56.80	363.39
50	−20.92	22.55	67.24	408.90
55	−26.08	25.17	76.81	455.35
60	−34.05	26.19	86.00	496.29
65	−45.84	23.22	91.76	528.85
70	−61.93	19.43	98.19	538.85

Progression of Whole Life Cash Values
Expense = $10 + 125% Net Level Premium
1965-70 Basic Ultimate Male (ALB) at 5%

Issue Age	Cash Value by Duration			
	1	3	5	20
25	−12.25	0.16	13.73	159.75
35	−13.31	7.41	29.62	242.60
45	−16.83	15.32	48.94	335.96
50	−20.36	18.69	59.30	383.52
55	−25.47	21.32	68.94	432.51
60	−33.38	22.42	78.35	476.38
65	−45.10	19.61	84.45	511.63
70	−61.08	16.11	91.46	523.76

Progression of Whole Life Cash Values
Expense = $10 + 125% Net Level Premium
1965-70 Basic Ultimate Female (ALB) at 4%

Issue Age	Cash Value by Duration			
	1	3	5	20
25	−11.74	1.09	14.87	151.05
35	−12.78	6.52	26.88	218.69
45	−15.36	12.90	42.58	313.61
50	−17.31	17.18	53.37	377.12
55	−19.95	22.75	66.95	443.84
60	−24.22	28.26	83.33	501.26
65	−29.45	38.10	107.27	552.46
70	−39.35	43.24	121.55	596.13

Issue Age 67 Select Values, 5%
Expense = $10 + 125% Net

	Male	Female
Net Premium	45.381389	35.225426
CV_1	−25.95	−19.42
CV_3	51.47	49.01
CV_5	126.37	116.29
CV_{20}	595.80	602.26
P^A	51.587003	39.70166
E	66.73	54.03

Issue Age 67 Ulitmate at 5%
E = \$10 + 125% Net

	Male	Female
Net	60.63464	44.553031
CV_1	−51.15	−31.85
CV_3	18.36	37.57
CV_5	87.83	107.86
CV_{20}	521.10	552.58
P^A	69.92208	50.607932
E	85.79	65.69

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Attachment E-2

TO: John O. Montgomery
California Insurance Department

FROM: C. F. B. Richardson
Crystal Falls, Florida

RE: Spencer Koppel Letter

I have reviewed Koppel's excellent letter of February 22 and my reactions are as follows:

The fact that cash values at early durations decrease with advancing age at issue does not bother me. Indeed, they probably should since first year commissions and other compensation per M will obviously increase with age at issue and underwriting and issue costs will probably increase also since there will be more costly medical costs at higher ages and average size decreases after age 40. So far as the public is concerned, there should be no problem since an insured looks only at the figures for his age.

I am not sure I understand the other problem discussed but it would appear that the proposed solution has merit.

Give the committee members my warmest regards. Judging by your agenda it looks as though I picked the right time to get off this assignment!

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Attachment E-3

TO: John O. Montgomery
California Insurance Department

FROM: Harold Leff, Actuary
PLI Technical Research

RE: Mr. Spencer Koppel's February 22, 1977 Letter

Mr. Koppel makes two points regarding the proposed new standard nonforfeiture law.

1. Cash Value Patterns

His first comment is that he is not satisfied by the pattern of cash values for higher issue ages. Specifically, he objects to the fact that early cash values using the proposed expense allowance formual for issue age x would exceed the comparable durational values for issue age x + t. Mr. Koppel's specific example was for ordinary life at issue ages 65 and 70. Following his approach, I calculated values based on '58 CSO (last birthday) at 4% interest and obtained similar results:

Ordinary Life -- Cash Value -- Proposed Expense Allowance -- 1958 CSO at 4%

t	Issue Age 65	Issue Age 70
1	−53.92	−75.31
2	−17.13	−34.41
3	19.06	5.87
4	54.52	45.67
5	89.24	85.04
6	123.22	123.90

The lower early year cash values at issue age 70 are due completely to the higher expense allowance of $116.99, compared with $91.19 for age 65. This pattern of cash values does not exist currently because of the arbitrary limit on net premiums of $40 per $1,000; this limit restricts the expense allowance to $46.

Mr. C. F. B. Richardson has prepared a paper on the development of the recommended expense allowance formula. Mr. Richardson's analysis indicated that while the expense allowance might be a little high on high priced plans, the current allowances are woefully inadequate on such plans, little business is sold in these fringe areas, and it is desirable to keep the formula as simple as possible.

As an example which Mr. Richardson's paper includes, consider a participating endowment at 65 issued at age 50. The proposed expense allowance formula of 125% net + $10 produces an expense allowance of $83.29. Functional cost data which Mr. Richardson used in his analysis produces an excess of first year over renewal expenses of $77.57, which is reasonably close to the formula expense allowance. Compared to the allowance under the present law of $44.03, the proposed formula represents a substantial improvement in equity.

Some other comments I have on this question are that (a) the law provides a basis for minimum values -- actual values are subject to the decisions of each company -- which will be based, among other things, on competitiveness and equity, (b) I wonder how many policyholders at these advanced ages will compare two sets of cash values for issue ages five years apart; and (c) the expense allowance factors are based on data for a group of "average" companies, and hence, would not be adequate in many cases for small, struggling, companies not able to operate as efficiently as well-established companies.

2. Open Policies

Regarding Mr. Koppel's second question, he is concerned about the expense allowance generated in an "open policy" at the time of a guaranteed unscheduled change to benefits or premiums. Many of Mr. Koppel's comments were raised previously and Jerry Scher had considered them (see attached memorandum) and concluded that the committee's position was appropriate.

However, Mr. Koppel has also analyzed the proposed formula for recalculating the expense allowance, and he has concluded that the resulting expense allowance is too high. While Mr. Koppel's analysis is correct, there is a relatively insignificant impact on cash values. The overstatement of adjusted premiums is extremely small -- for the two examples Mr. Koppel has analyzed the error in adjusted premiums is 6½ cents and 9 cents. (I also tested the overstatement at issue age 50/change at age 55. In this case, the overstatement in the adjusted premium was about $.25, compared to an adjusted premium of about $77, again relatively insignificant.)

Mr. Koppel's recommended definition at the bottom of page 2 of his letter to Mr. Montgomery needs one clarification -- the "reserve" which he refers to bears no relationship to the policy reserve, and the use of the word reserve may be misleading. I'd suggest that "reserve" and the words following be replaced by:

> by the policy over the excess of (a) over (b), where (a) is the present value at the time of change of the benefits which were guaranteed just prior to the change, and (b) is the present value at the time of change of the nonforfeiture net level premium in effect just prior to the change.

As is obvious from the preceding paragraphs, an extremely more complicated definition is necessary to gain minor increases in cash values. In the interest of simplifying the language, I do not believe the slight inaccuracy is significant enough to warrant a change in the proposed law.

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Attachment E-4

TO: John O. Montgomery
California Insurance Department

FROM: J. R. Scher, Manager
Actuarial Corporate Studies

DATE: March 17, 1976

RE: Response to Mr. Koppel's Comments on "Open Policies"

Mr. Koppel has described three situations which he believes will not be properly handled by the committee's recommendations. Since each of his three situations touches on a slightly different problem, I will answer them one at a time.

Mr. Koppel states that our proposal "... could result in a policyholder who started with, say, a $10,000 policy and changed it to a $20,000 policy, and then back to a $10,000 policy, having less cash value than he would have had had he kept the $10,000 policy all along." This is true and rightly so, considering all the additional work and expense the company had undertaken to process the two changes.

Mr. Koppel, referring to the above example, says that "... this same policyholder could have been better off, except for the expense savings associated with quantity discount factors, had he bought a $10,000 policy originally and then bought a separate $10,000 policy, which he ultimately lapsed." This might be true if he purchased the second policy for a very brief period prior to lapsing. However, Mr. Kopel is not pointing to a flaw in our recommendation; he is merely showing how a clever policyholder can beat a perfectly rational system.

Mr. Koppel says "... a person who buys a $10,000 policy and then increases it to $20,000 is worse off than the person who simply buys two $10,000 policies." First, let's assume that any increase in benefits under the "open policy" is subject to evidence of insurability. This will keep the open policy benefits consistent with separate, subsequent purchases. If the economies of life cycle policies are realized, the insured won't be worse off unless she lapses one of her two policies almost immediately.

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ATTACHMENT F

TO: John O. Montgomery, Chief Actuary
and Deputy Insurance Commissioner, California

FROM: W. Keith Sloan
Arkansas Insurance Department
400 University Tower Building
Little Rock, Arkansas 72204

DATE: February 14, 1977

One of our domestic companies has asked a question regarding our annuity nonforfeiture law which I think deserves our looking into. At the very first of Section 2, we have exempted group annuities purchased under retirement plans or deferred compensation plans except IRA's and this makes a good bit of sense. However, there are retirement plans or deferred compensation plans in which individual annuity policies are used as if they were group annuities. Under those circumstances it would seem logical to extend the exemption to them. This could not necessarily be done directly by eliminating the word group since that would exempt a lot of keough plans and the degree of expertise in these as about the same as in the IRA's so the exemption would not be appropriate. We did not do anything with this particular part of the bill this year, but I think that it is something we need to address in our task force with the thought of making a minor amendment to the bill for the use of other states as it comes up such that we could correct it in our next legislative session.

Also, at the suggestion of another domestic company we are making one small modification and again I think that our task force may wish to at least consider it for general use. At the very end of the first paragraph of Section 4(A) we have added the words "less any contractual prepayment penalty thereon." The reason for this is that some annuities are being issued with a provision that if the insured agrees that his intention is to maintain the contract in force for a specified number of years a larger current rate of interest is allowed than would be applicable if he did not make such an agreement. If on the other hand for some reason he does not maintain the contract in force for a specified number of years, the cash value including additional interest is calculated as if it had been on the lower basis in the first place. This particular company has advised me privately that their 8% accumulation contracts with the intergrow limitation on withdrawal do persist much better than their 6% contracts without. Since we are really interested in promoting long term use of annuities rather than the equivalent of a bank savings account, it seems to me that this can be a desirable addition. I have discussed it with the ACLI also and their impression was also favorable.

I hate to interject old business into our meeting next month but sometimes the best way to learn about a bill is to introduce it and get comments, and I think that this feedback has been quite useful.

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Attachment F-1

TO: John O. Montgomery, Chairman
NAIC Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation

FROM: Howard H. Kayton, Vice President and Actuary
Security First Group
1800 Avenue of the Stars, Los Angeles, California 90067

DATE: March 31, 1977

RE: Individual Deferred Annuities Model Bill

The purpose of this letter is to describe a problem that we have noted with respect to the NAIC standard nonforfeiture model law for individual deferred annuities. The problem relates to what I believe is an inadvertent supression of terminally-loaded deferred annuities.

To better understand the problem, let me first describe our annuity product. The Accumulator (the contract that is marketed in California) is a non-front-load flexible premium annuity contract that contains a seven year guarantee on funds previously received. The current guarantee is 6.75% for seven years and 3% thereafter. Since the guarantee is at a very competitive rate, it is necessary to include a surrender charge to recover unamortized acquisition costs, as well as to avoid the problems of financial antiselection. The surrender charge also helps to emphasize that the Accumulator is an annuity product, and not a savings account type product. In fact, we believe that this terminal load will help us to convince the SEC that the product is not a security, and to convince the IRS that Accumulator is not a deposit account.

The appeal of this product is well documented by the deposit of over $140,000,000 of purchase payments under this program in 1976, of which $26,000,000 was in the State of California.

Your NAIC task force, when drafting the model bill for nonforfeiture values, recognized the problems inherent if it were to require total actuarial equivalence of the annuity values and cash surrender values. The solution selected by your task force was to allow the cash surrender values prior to maturity to be less than the actuarial equivalence of the annuity value at that time, but it also required that the cash surrender value grade into the maturity value. Thus there is no allowance for a surrender charge such as that commonly found in "no-front-load" annuity contracts, i.e., terminally-loaded annuity contracts. This is clearly documented in Attachment B to your November 4, 1976 letter to your task force.

The net impact of your solution is to penalize the company offering a competitive guaranteed yield, but only if the company offers surrender values (which are not required under the NAIC law) and only if the company chooses the more consumer oriented approach of a terminal load (which in the case of Security First Group is considerably lower than the permissable 35% first year and 12.5% renewal year <u>front-load</u> – our product has a 7% level terminal load, only if the funds are <u>not</u> applied under an annuity option). The higher yields on our product design are evident, and are far in excess of the minimum yields as developed by your task force, and as illustrated in Attachment B of your letter (see Table 1 for a comparison of such yields with those under Accumulator).

I do not believe that it was your task force's intent to restrict the design of annuity products to the front-loaded product. Your task force, and that of the Society of Actuaries, have both been outspoken in their concern over laws that restrict innovation in product design. The inadvertent restriction on this product was probably due instead to an oversight on our part in not emphasizing this particular design, which is definitely in the public interest, before your task force.

I would therefore propose that your task force adopt a position that would permit interpretation of the model bill to permit the substitution of a terminal loading which is not greater than the actuarial equivalence of the front-load as specified in that bill. Also, as part of your revision of the SNL (which is presently underway) I recommend inclusion of additional wording to Paragraph 6 of the annuity SNL which would read as follows:

> However, for contracts that provide that the maturity value will be determined by crediting interest to the gross consideration without any deduction other than the maximum annual contract charge provided under Section 10168.2, (except for any applicable premium taxes), the contract may provide for a surrender charge not in excess of 10% of the amount required to be otherwise payable under this section.

Note that above wording produces surrender charges which are less than those permitted under a front-loaded contract, but which avoids problems with all of the terminally-loaded products which I am familiar with.

John, if you would like to discuss this further, or would like our help in drafting more appropriate language, please feel free to call.

TABLE I

NAIC Model Nonforfeiture Law for Individual Deferred Annuities
Comparison of Yields with SFG "Accumulator"

$10,000 Single Premium

	Minimum Nonforfeiture Values		SFG Guarantee Surrender Values		Minimum Disc. Maturity Values	
	Cash Value	Gross Yield	Surr. Value	Gross Yield	Cash Value	Gross Yield
1	9,200	−8.00%	9,913	−0.87%	9,200	−8.00%
2	9,476	−2.65	10,567	−2.80	9,476	−2.65
3	9,761	−0.08	11,265	−4.05	9,761	−0.08
4	10,054	.13	12,011	4.69	10,054	.13
5	10,355	.70	12,807	5.07	10,355	.70
6	10,666	1.08	13,656	5.33	10,666	1.08
7	10,986	1.35	14,563	5.52	11,531	2.06
10	12,004	1.84	16,401	5.07	12,971	2.64
15	13,916	2.23	18,937	4.35	15,781	3.09
20	16,132	2.42	21,876	3.99	19,200	3.32
25	18,701	2.54	25,285	3.78	23,360	3.45
30	21,679	2.61	29,235	3.64	28,421	3.54
35	25,132	2.67	33,816	3.54	34,678	3.61
40	29,134	2.71	39,125	3.47	42,070	3.66
Annuity Value (Dur. 40)						
	29,134	2.71	42,070	3.66	42,070	3.66

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ATTACHMENT G

American Council on Life Insurance
April 15, 1977

Re: Reserve Requirements for the December 31, 1976 Valuation with
Respect to Interest Rate Guarantees on Active Life Funds
Held Relative to Group Annuity Contracts

As part of the determination of the aggregate minimum group annuity reserves, a computation must be made of minimum reserves for deposit administration group annuity funds with interest rate guarantees including all such funds pertaining to possible purchase of group annuities whether such funds are held in a separate account or in a general account, whether shown as premiums, advance premiums, auxiliary funds, etc. and whether the liability is shown in Exhibit 8 or elsewhere. In making such computation, the procedure and minimum standards described below shall be applicable for the December 31, 1976 valuation giving recognition to the dates deposits were made. Where appropriate and with the approval of the commissioner, recognition may be given to the extent and time of application of active life funds to purchase annuities, expense assessments against the fund, and excess of purchase price over minimum reserves. In no event shall the reserve be less than the transfer value, if any, of the fund. Approximate methods and averages may be employed with the approval of the commissioner.

To the extent that the application of these valuation procedures and standards would require a company to establish aggregate minimum reserves for group annuities and related funds in excess of reserves which it would otherwise hold if these valuation procedures and standards did not apply, such company shall set up an additional reserve liability whether shown in its general account or in a separate account, whether shown in Exhibit 8 or elsewhere.

For funds received:

(1) Prior to calendar year 1974, follow the procedure used at that time.

(2) In calendar year 1974 or later, follow the minimum standards prescribed below:

(a) Contracts having no guaranteed interest rates in excess of 6% on future contributions to be received more than one year subsequent to the valuation date.

The minimum reserve shall be equal to the sum of the minimum reserves for funds attributable to contributions received in each calendar year.

Where V_y = Minimum reserve for funds attributable to contributions received in calendar year y.

$$V_y = [C_y \times (1 + i_{gy})^n] / (1 + i_{py})^n$$

C_y = Portion of the guaranteed fund attributable to contributions received in calendar year y.

i_{gy} = Interest rate guaranteed under the contract with respect to funds attributable to contributions received in calendar year y.

i_{py} = Lowest of:

(1) The net new money rate credited by the company on group annuity funds attributable to contributions received in calendar year y less .005, or

(2) i_{gy}, or

(3) i_{my}, where

i_{my} = (i) for calendar years y + 1 through y + 10 the values shown in the attached table of values of i_{my}.

(ii) for calendar years y + 11 and later, .060.

n = Number of guarantee years, and fractions thereof, remaining as of the December 31 valuation.

+

(b) Contracts having guaranteed interest rates in excess of 6% on future contributions to be received more than one year subsequent to the valuation date.

The same procedures as set forth under (a) above shall be used except that for funds attributable to contributions received in calendar year 1976 or later the deduction under (1) of i_{py} shall be .01 instead of .005 and i_{my} shall be reduced by .005.

Table of Values of i_{my} with Respect to Funds Attributable to
Contributions Received in Calendar Year y

Calendar Year y in Which Contributions Were Received*	Value of i_{my} for calendar years y + 1 through y + 10 with respect to funds attributable to contributions received in calendar year y									
	y + 1	y + 2	y + 3	y + 4	y + 5	y + 6	y + 7	y + 8	y + 9	y + 10
1974	.075	.075	.075	.075	.075	.075	.075	.075	.075	.075
1975	.081	.081	.081	.081	.081	.077	.073	.069	.065	.060
1976	.089	.089	.089	.089	.089	.089	.089	.089	.089	.089

* For contributions received in calendar years 1975 through 1976 these factors were based upon gross new money rates for reporting annuity writing companies less .01.

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ATTACHMENT H

American Council on Life Insurance
Special Actuarial Committee
Renewable Term Insurance -- Discussion Draft

(This draft had not received full approval of all members of the submitting committee at the time it was presented to the technical task force.)

At one time, term insurance renewals were at the company's option and only the current term period was involved in the valuation process. But renewable term insurance has come to mean term insurance under which the insured has a right to renew at specified premiums at the end of the initial term period for one or more subsequent periods -- and the standard valuation law is not completely clear as to the proper treatment of reserves in these circumstances.

We found we had to begin our discussion with the question of basic policy reserves.

Section 4 of the standard valuation law (Attachment A-2 to the report of the December 8, 1976 meeting of the NAIC Life Insurance (C3) Subcommittee) provides that in the case of life insurance policies requiring the payment of uniform premiums, net premiums should be a uniform percentage of the respective contract premiums. . . . Later, under Section 4, it provides that reserves for life insurance policies requiring the payment of varying premiums should be calculated by a method consistent with the principles. . . . preceding.

We believe the primary purpose behind requiring net premiums to be a uniform percentage of gross premiums in the case of level premium policies is to prevent manipulation of net premiums so as to produce reserves below the minimum intended. In the case of a policy of renewable term insurance, which in intent is structured under a stream of consecutive policies approach, it would be in accord with the principle of this requirement to provide that the net premiums in each term period should be a uniform percentage of the gross premiums for that term period. Reserves would then be calculated for the policy over its entire period of guaranteed renewability, but it should be noted that resulting reserves would be the same as reserves computed for the original term period and for each renewal period separately. (Assuming modification under the commissioner's method is not elected.)

We do not believe the purpose nor the letter of the law insists that net premiums for the entire guaranteed renewable period should be computed as a single uniform percentage of the gross premiums for the plan. Such an interpretation results in variation in basic reserves according to the incidence of gross premiums -- and the variation could be arbitrary and unreasonable. Two companies offering identical benefits could be required to set up markedly different basic reserves.

As an example, consider company A offering yearly renewable term insurance where the gross premium at each issue or renewal age is set to equal a net one year term premium based on 1958 CSO mortality. For such a company, mean reserves would be the same (one-half such net premium) whether net premiums for valuation purposes were calculated year-by-year or as a uniform percentage of gross premiums for the entire renewal period. Suppose company B provides identical benefits but charges gross premiums equal to the same net premiums plus a constant charge per $1,000 insurance. Company B would hold the same reserves as company A if net premiums for valuation purposes were calculated year-by-year but would be forced to hold higher reserves than company A if net premiums were taken as a uniform percentage of gross premiums over the entire renewal period. Yet company B is charging higher gross premiums, and neither company would be required to hold deficiency reserves under any difinition.

The question of deficienty reserves for renewable term insurance is also clouded. Neither the current version of the law in effect in most states nor the new language proposed for adoption (see Section 7 of the A-2 attachment to the (C3) Subcommittee report) clearly spells out the requirements. There has been wide disparity of treatment by different states, as to different products, and for different companies with respect to the minimum deficienty reserves required on this type of business. The problem is an urgent one. These differing standards have produced inequitable results between carriers and make it difficult to price and market this business on a rational basis.

We suggest that the NAIC supply a model interpretation of the standard valuation law under which basic reserves on renewable term insurance would be set on the stream of policies theory as described above. Because the law is not clear, however, we suggest that deficiency reserves be required as a matter of statute only for the current term period where net premiums exceed gross premiums for such period, and that the NAIC so interpret the current law.

However, we recognize that it is important as a matter of solvency that adequate reserves be established for contracts of this kind to protect against the eventuality of possible future inadequate premiums. We believe the NAIC should suggest that states adopt a model requirement that additional reserves be held in cases where net premiums on a more modern mortality basis exceed gross premiums for future term periods. For this purpose, we suggest a table such as the "Modern CSO" table developed for testing by the Society of Actuaries' Special Committee on Valuation and Nonforfeiture Laws (see page 40 of the report of this committee).

The "Modern CSO" table and the maximum interest rate permitted by law should be used to compute net premiums to measure future renewal period deficiencies, and also to take their present value in computing the additional reserve to be held. We discussed a number of formulas for taking the present values, and leaned toward an approach where any sufficiencies on this basis could be used to offset future deficiencies, but not past deficiencies.

We have studied many possible formulas for computing reserves of this type for renewable term insurance, with a careful eye to the possibilities of manipulation to undo the intent of the requirements, and concluded this is the best and fairest formula for these policies. In the last analysis, though, the deficiency reserve problem lies in an outmoded mortality table, not in the formula.

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ATTACHMENT I

TO: Mr. Burnett A. Halstead, Jr., Actuary
Federal Kemper Life Assurance Company
Long Grove, Illinois 60049

FROM: Ardian Gill, F.S.A., F.C.I.A.
Senior Vice President and Chief Actuary
MONY the Mutual Life Insurance Company of New York
Broadway at 55th Street, New York, New York 10019

DATE: January 5, 1977

RE: Deposit Term Insurance

John Montgomery has given me a copy of your letter of October 21, 1976 to him. In that letter there occurs the following, "We have written to the Society of Actuaries regarding this, but they do not seem interested in obtaining our input."

I have made inquiry of the secretary of the Society and he assures me that he has had no such communication from you. Upon further inquiry of the committee members, I discovered that you wrote to Mr. Henry Unruh, former chairman of the committee, last June 11. Apparently Henry considered the letter directed to him as chairman of the Provident, not as past chairman of the committee, and I would have taken the letter in the same way. Mr. Baucom did respond on his behalf explaining the Provident's position.

Thus, the only letter that I have been able to discover that fits the description in your letter to John Montgomery seems to have been answered. If there is something further that you wish from the committee, I would be happy to hear from you again. I would like to point out, however, that I have been unable to find anything in your letter that points to an incorrect principle in our report; in fact, many of your comments suggest to me that your reading of our report has been less than thorough. It is important to recognize that our committee tried to approach everything from principle, as we were charged by the Board of Governors, and it is undoubtedly this adherence to principle that caused the then chairman of the committee to preside "over a committee that was responsible for destroying one of [his] favorite policies." (Wording from your letter to Mr. Unruh.) In this connection, I would like to point out that protecting vested interests is not a principle.

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Attachment I-1

TO: Mr. John O. Montgomery, Chief Actuary
California Insurance Department

FROM: Burnett A. Halstead, Jr.
Kemper Life Insurance Companies
Long Grove, Illinois 60049

DATE: October 21, 1976

RE: "Deposit Term" Insurance

It is our understanding from John Booth of the ACLI that you are chairman of an NAIC task force concerned with new nonforfeiture laws. This letter is directed to you in that capacity.

The Society of Actuaries prepared a report dated January, 1976 which dealt with a number of nonforfeiture matters. One of these items was "Deposit Term" insurance.

We are concerned about some of their proposals which relate to "Deposit Term" insurance. Our concern is related to the fact that we write a substantial volume of this type of business and the proposals made in the report, if enacted, would have a significantly adverse affect on our operations.

Our feeling is that the proposals are not in order. We have written to the Society of Actuaries regarding this, but they do not seem interested in obtaining our input. We have also written the ACLI and have had some helpful views from them.

As one of the largest writers of this type policy, if not the largest, it seems to us our views should be considered before any model laws are prepared which would cause us substantial harm.

Hopefully we could obtain an unbiased hearing with you or your group on this subject. We would be glad to meet whenever a convenient time could be arranged.

We look forward to hearing from you on this matter.

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Attachment I-2

TO: Mr. Ardian C. Gill
Senior Vice President and Chief Actuary
Mutual of New York, New York, New York 10019

FROM: B. W. Baucom, F.S.A., Vice President and Actuary
Provident Life and Accident Insurance Company
Chattanooga, Tennessee

DATE: July 7, 1976

RE: Deposit Term Insurance

Attached are copies of an exchange of correspondence between Burnett Halstead and myself on the subject of deposit term. My letter to Mr. Halstead was at Henry's request and in response to Mr. Halstead's questions about Henry's remarks at the Chicago meeting. Mr. Halstead apparently interpreted my response as being on behalf of the committee which was not intended.

I don't believe there is any point to continuing this exchange of correspondence because I don't think anyone's position is going to change on the subject. However, since Mr. Halstead is making a direct plea to the committee, I felt it would be appropriate to send the correspondence on to you in case you wanted to pursue the matter. If I can do anything to assist in this area, please feel free to call on me.

We are continuing to work on the assignment from the previous meeting concerning John Montgomery's request. We should have results completed and available within the next few weeks.

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Attachment I-3

TO: Mr. Ben W. Baucom, Vice President and Actuary
Provident Life and Accident Insurance Co.
Chattanooga, Tennessee 37402

FROM: Burnett A. Halstead, Jr.
Kemper Life Insurance Companies
Long Grove, Illinois 60049

DATE: July 2, 1976

RE: Deposit Term Insurance

Your letter regarding deposit term was appreciated. I find it interesting.

I find your comments paradoxically inconsistant, though. On the one hand, you admit to enthusiasm regarding the product. On the other hand, the committee felt and you apparently agreed, it was "totally inconsistent with any ligitimate marketing approach to deposit term" to pay the kind of commissions that are necessary to get the product sold.

It is difficult to understand how the committee can justify a \$1,000 commission to sell a whole life policy for a given amount and age and cannot justify the same \$1,000 commission for a deposit term policy. It takes the same amount of effort by the agent. You didn't comment on this blatant type of discrimination.

The vast majority of whole life policyholders are, after all, when lapse rates are considered, really just deposit term policyholders. It apparently is justifiable for insurance companies to confiscate the investment money put into a "whole life" policy in order to pay commissions. It apparently isn't justifiable to confiscate the investment money put into a deposit term policy for the same purpose.

The committee's action on deposit term would make a lot more sense if the same commission limitations imposed on deposit term were imposed on all products. Deposit term policies, even the worst of them, generally confiscate less money for commissions than most whole life policies being sold.

The fact that this basic discrimination exists between whole life and deposit term means, of course, that special rules for deposit term will, in the end, have no real effect anyway. Actuaries with ingenuity will simply refine the deposit term features of ordinary life policies to accomplish what they were doing with pure deposit term policies.

For a committee of the Society of Actuaries to deliberately go after a specific policy in such an obviously discriminatory fashion does not seem to me to do much credit to either the committee or the Society. The whole matter could be generally embarrassing when the companies and agents affected realize what is being done to them.

Worse, of course, is the fact that the product is basically consumer oriented. Combined with a variety of available investment alternatives, it is relatively easy to demonstrate the product is a better buy than the usual whole life policy. Sophisticated buyers have recognized this fact and a number of consumer groups have begun to recognize it also.

Isn't the proposed legislation really an attempt to eliminate the threat deposit term poses to whole life companies? If that is the case, how can the Society justify to itself, the Justice Department, or to anyone the destruction of a product simply so the whole life companies won't have to worry about competition? It seems to me to be irresponsible behavior.

The tone of your letter indicated the committee is not open-minded about this subject and has pretty much committed itself. I hope this is not the case because I think they are making a mistake.

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Attachment I-4

TO: Mr. Burnett A. Halstead, Jr., Actuary
Kemper Life Assurance Company

FROM: B. W. Baucom, Actuary
Provident Life and Accident Insurance Company

DATE: June 23, 1976

RE: Deposit Term Insurance

Mr. Unruh has asked that I respond to your letter to him of June 11 on the subject of deposit term. I worked with Mr. Unruh in support of his nonforfeiture committee activities and I am familiar with the deposit term subject, both from that point of view and from having dealt with our company's product.

We share your enthusiasm for the deposit term concept and agree that the policy offers the buyer a unique alternative to complete the term portion of his portfolio. It is our firm belief that the approach the committee took in the determination of minimum values for deposit term is a constructive one, both from the point of view of the buyer and the insurance industry (including the selling agent).

Certainly we agree with your comments that regulatory authorities have been overly critical of deposit term contracts. Some of their criticisms have been unfounded while, in our opinion, some of them have been litigimate. Some states have criticized the discriminatory aspect of a zero cash value in the ninth year with a full deposit plus accumulated interest available at the end of the tenth year. Having been faced with some real life problems of what happens when a deposit term contract approaches the end of its deposit term period, we now feel that this discriminatory concern is a legitimate one.

In all marketing approaches to deposit term that I am familiar with, one of the key points is that the deposit is unencumbered and left to earn interest over the deposit period. Given that situation, the committee concluded that it is inappropriate to permit a full percentage expense allowance on the deposit as is effectively done in the current law. We were aware that some companies do pay a commission on the deposit but in our opinion the payment of such a commission is totally inconsistent with any legitimate marketing approach to deposit term.

Thus, as you say, it remains to be seen whether or not the committee efforts will result in a problem with respect to the marketing of deposit term. It is our belief though that the recommendations of the committee will have the effect of answering the legitimate criticisms of deposit term and perhaps make the concept more universally acceptable to the industry, to the regulators and to the public in general.

We appreciate your thoughts and we share your hope that the marketability of deposit term will not be undermined by our conclusions.

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Attachment I-5

TO: Mr. Henry Unruh
Chairman of the Board and Chief Executive Officer
Provident Life and Accident Insurance Company
Chattanooga, Tennessee 37402

FROM: Burnett A. Halstead, Jr.
Kemper Life Insurance Companies
Long Grove, Illinois 60049

DATE: June 11, 1976

RE: Deposit Term Insurance

This letter relates to your statement indicating you would not like to think that you had presided over a committee that was responsible for destroying one of our favorite policies. You made this statement, I understand, during a discussion of nonforfeiture proposals as they relate to deposit term.

The statement puzzles me, since I am convinced the proposed legislation, if enacted, will force some significant changes in deposit term as it is written today. Whether or not the product will be effectively killed as a result, of course, remains to be seen. The major problem is that adequate commissions will no longer be possible in order to get the product sold.

There is no question that the committee has chosen to discriminate against deposit term. Compare the commission that could be paid for a $100,000 ordinary life policy with what could practically be paid for a $100,000 deposit term policy under the proposed law and the discrimination becomes obvious. Clearly, no financially motivated agent would sell the deposit term policy, even though it is probably better for his client.

It is understandable that the large established companies would want to legislate deposit term out of existence. Combined with other investment vehicles in a "roll your own" type ordinary policy, it represents a more flexible and a more viable product to the consumer than conventional ordinary policies. This represents a significant threat to large blocks of conventional type business currently in force.

The established companies have been able to convince some regulatory officials the policy is bad in spite of the fact that the policy type has definite consumer advantages. One main reason seems to relate to the amount of replacement activity surrounding the policy. The regulatory people do not seem to be perceptive enough to realize that whole life policies, net of their investment element, are really just another type of deposit term policy.

Your committee is dominated by established company officials, who, no doubt, in good conscience are acting in what they believe the best interest of their companies and the industry. They are not acting in the best interest of the companies selling the product, my company in particular, and I question whether they are in the long run acting in the best interest of the public.

Deposit term has revolutionary overtones and the insurance industry, probably as most industries, (and most people for that matter) is not prone to accept revolutionary ideas even when they may, in the end, be beneficial to the industry and the public. Although I can understand it, I find the situation somewhat sad.

This brings me back to your statement and why it puzzles me. I am aware that your company, Provident Life and Accident, and perhaps you personally, were the originators of at least one form of deposit term. I can thus understand why you might have an interest in the subject. What seems contradictory, though, is that you would permit the product to be put in such a precarious position if you really have an interest in preserving the form.

I hope these comments are of some interest. I really hope they convince you that the committee's action should be reversed. Realistically this probably is a forlorn hope, but I thought I sensed some possibility in your statement.

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ATTACHMENT J

TO: John O. Montgomery, Actuary
California Insurance Department

FROM: Harold Leff
Senior Actuarial Associate

DATE: May 2, 1977

RE: Proposed Nonforfeiture Value Formula for Deposit Term

The Society of Actuaries' Special Committee on Nonforfeiture Laws recommended that expense allowances be based on levelized net premiums, rather than the first year adjusted premium. This recommendation has a fairly substantial impact on Deposit Term – Appendix N of the special committee's report provided an illustration of this recommendation (copy attached).

The NAIC task force raised some additional questions regarding deposit term at its March 30–April 1 meeting in San Francisco. Specifically, they requested a demonstration that the special committee's proposal would produce reasonable nonforfeiture values for deposits of different amounts.

The attached tables correspond to the first table shown in Appendix N of the report – minimum cash values have been calculated for issue ages 25, 35 and 45, and for initial deposits of $7.50, $15.00 and $50.00. The "test formula" used for these calculations is the one shown on page 28 of the report.

As can be seen from the tables, the special committee's recommended treatment of deposit term produces reasonable minimum values regardless of the size of the initial deposit.

APPENDIX N

Test of Deposit Term

It is recommended that plans with identical benefits and identical premium-paying periods have identical expense allowances. Applying this proposal in conjunction with the test allowance to an actual deposit term contract, we have the following comparison of minimum cash values.

Deposit Term
8-Year Renewable and Convertible Term
1958 CSO -- 3½ Percent Curtate
Age 35

($1,015 of Term Insurance/$15 Pure Endowment; Annual Premium $1.49 Plus $7.50 Deposit)

	Minimum Cash Value	
Duration	Current Method	Test Formula
0	−$32.53	−$14.84
1	− 15.47	− 2.74
2	− 10.94	0.17
3	− 6.40	3.03
4	− 1.90	5.78
5	2.53	8.39
6	6.84	10.82
7	11.00	13.03
8	15.00	15.00

Do the resulting values provide a reasonable result? The sales literature indicates "deposit to double" at a return over eight years of 9.05 percent compounded annually; thus a reasonable result might be something approaching the minimum cash value for the term portion of the contract plus the accumulation of the deposit at the guaranteed rate of 9.05 percent.

The following shows the results of this test.

Duration	Minimum Cash Value $1,015 Term	$7.50 (1.0905)^n	Total
0	−$13.26	$ 7.50	−$ 5.76
1	− 11.13	8.18	− 2.95
2	− 9.06	8.92	− 0.14
3	− 7.07	9.73	2.66
4	− 5.22	10.61	5.39
5	− 3.55	11.57	8.02
6	− 2.10	12.61	10.51
7	− 0.90	13.75	12.85
8	0	15.00	15.00

Expense Allowance:

Current:

$$0.02(ELA) + 0.40 \begin{bmatrix} 11.99(r) \\ 0.40(ELA) \end{bmatrix} + 0.25 \begin{bmatrix} OL^a(ELA) \\ 11.99(r) \\ 0.04(ELA) \end{bmatrix} = \$32.53$$

Test Formula:

$$0.01(ELA) + 0.50 \begin{bmatrix} L_p \\ 0.05(ELA) \end{bmatrix} + 0.50 \begin{bmatrix} OL(ELA) \\ L_p \\ 0.05(ELA) \end{bmatrix} = \$14.84$$

ELA = \$1,015 equivalent level amount of insurance;

OL^a = Ordinary life adjusted premium per dollar of insurance under current law;

OL = Ordinary life net premium per dollar of insurance;

L_p = Uniform level net premium, i.e., $L_p\,(\ddot{a}_{35:\overline{8|}}) = 1{,}015\,(A^{1}_{35:\overline{8|}}) + 15\,(A_{35:\overline{8|}}^{\;\;1})$;

r = Uniform percentage of varying gross premium for expressing adjusted premium.

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Deposit Term

8 Year Renewable and Convertible Term
1958 CSO – 3½% Curtate

Issue Age 25

	Case I		Case II		Case III	
	\$1,015 Term/\$15 Pure Endowment Ann. Prem. = \$3.28 + \$7.50 Deposit Minimum Cash Value		\$1,030 Term/\$30 Pure Endow. Ann. Prem. = \$3.32 + \$15 Deposit Minimum Cash Value		\$1,100 Term/\$100 Pure Endow. Ann. Prem. = \$3.55 + \$50 Deposit Minimum Cash Value	
Duration	Current	Test Formula	Current	Test Formula	Current	Test Formula
0	-\$31.10	-\$13.78	-\$37.68	-\$15.55	-\$ 42.45	-\$ 23.78
1	- 13.60	- 1.96	- 4.24	7.77	51.94	57.47
2	- 9.81	.34	.27	10.75	58.21	63.03
3	- 5.93	2.68	4.90	13.79	64.66	68.76
4	- 1.94	5.07	9.66	16.90	71.33	74.67
5	2.14	7.50	14.55	20.07	78.19	80.74
6	6.33	9.96	19.57	23.32	85.25	86.98
7	10.61	12.46	24.72	26.63	92.52	93.40
8	15.00	15.00	30.00	30.00	100.00	100.00

Deposit Term
8 Year Renewable and Convertible Term
1958 CSO – 3½% Curtate

Issue Age 35

	Case I		Case II		Case III	
	$1,015 Term/$15 Pure Endowment Ann. Prem. = $4.49 + $7.50 Deposit Minimum Cash Value		$1,030 Term/$30 Pure Endow. Ann. Prem. = $4.56 + $15 Deposit Minimum Cash Value		$1,100 Term/$100 Pure Endow. Ann. Prem. = $4.87 + $50 Deposit Minimum Cash Value	
Duration	Current	Test Formula	Current	Test Formula	Current	Test Formula
0	-$32.53	-$14.84	-$38.47	-$16.63	-$ 43.73	-$ 24.85
1	- 15.47	- 2.74	- 6.79	6.45	47.41	54.25
2	- 10.94	.17	1.45	10.09	54.77	60.73
3	- 6.40	3.03	3.92	13.71	62.23	67.29
4	- 1.90	5.78	9.28	17.27	69.77	73.89
5	2.53	8.39	14.62	20.71	77.34	80.49
6	6.84	10.82	19.86	24.00	84.93	87.06
7	11.00	13.03	24.99	27.11	92.48	93.57
8	15.00	15.00	30.00	30.00	100.00	100.00

Deposit Term
8 Year Renewable and Convertible Term
1958 CSO – 3½% Curtate

Issue Age 45

	Case I		Case II		Case III	
	$1,015 Term/$15 Pure Endowment Ann. Prem. = $9.18 + $7.50 Deposit Minimum Cash Value		$1,030 Term/$30 Pure Endow. Ann. Prem. = $9.31 + $15 Deposit Minimum Cash Value		$1,100 Term/$100 Pure Endow. Ann. Prem. = $9.94 + $50 Deposit Minimum Cash Value	
Duration	Current	Test Formula	Current	Test Formula	Current	Test Formula
0	-$34.78	-$18.84	-$40.69	-$20.62	-$ 46.00	-$ 28.99
1	- 18.49	- 5.77	- 12.17	2.35	35.94	44.75
2	- 12.45	- 1.34	- 5.03	7.66	45.85	53.50
3	- 6.70	2.74	1.86	12.64	55.62	62.16
4	- 1.33	6.37	8.42	17.21	65.17	70.50
5	3.62	9.51	14.60	21.33	74.46	78.54
6	8.04	12.05	20.30	24.88	83.40	86.18
7	11.86	13.91	25.47	27.81	91.94	93.36
8	15.00	15.00	30.00	30.00	100.00	100.00

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ATTACHMENT K

TO: (C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation

FROM: J. Ramon Estafania, Actuary
South Carolina Department of Insurance
2711 Middleburg Drive, Columbia, South Carolina 29204

DATE: March 17, 1977

RE: Discriminatory Practices by Age

Recently, my department had disapproved a product for a large company because the cash values and the nonforfeiture values were calculated with variations of interest by groups of ages. We took this action considering that South Carolina's Code Section 37-1212 "Unfair Discrimination in Life Insurance" prohibits the practice of discrimination by age. Most other states have a similar prohibition and, therefore, I think the problem affects the whole country.

In making this discovery by a rather refined scrutiny, we discovered that six or seven companies have in the past filed products which discriminate by age without alerting our policy analysts. Since the policy department thought it to be a normal product, they did not refer it to the actuarial department for analysis.

It is very difficult to detect this practice in the normal checking of the policy forms if the filing itself does not state very clearly the use of different interest rates for different age brackets.

The reason given by the companies is that it permits different cash values at different ages for competitive reasons, and once a company has a product of this kind approved, for the same reason other companies also want to discriminate by age.

It has been a normal practice until now to discriminate interest rates by the variable time, meaning varying the interest rate according to the economic expectations for the future, so this practice should not be confused with the discrimination by age of the insured, the subject of this letter.

I would like to include a discussion of this subject during the meeting of the committee in San Francisco to find if this practice violates the nonforfeiture statutes; and if it has to be curtailed, then speed would be essential. I have the names of some companies which we know have products of this kind, perhaps approved in most of the states, that I will bring up during the meeting.

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ATTACHMENT L

TO: Mr. John O. Montgomery
Chief Actuary and Deputy Insurance Commissioner
California Inusrance Department

FROM: W. Keith Sloan
Arkansas Insurance Department
400 University Tower Building
Little Rock, Arkansas 72204

DATE: March 16, 1977

I am enclosing a copy of a method one company uses for establishing a mortality fluctuation reserve which I requested after noticing one in their annual statement. I have in the process of getting this ready to send to you deleted the company's actual loss ratios and reserve increment constants replacing them with subscripted k's. I should point out that for this particular company some of the constants are the same from line to line but not all and in the general case they should be determined separately for each line and for each company.

I think that this is a simple enough format that our task force could use it as a basis for minimum surplus determinations after we had determined scales appropriate for the determination of the perimeters. I think also that this can be expanded into other lines such as accident and health but that where this is done trends will have to be taken into account. I am also thinking of attempting to adapt this idea into a fluctuation reserve for Blue Cross or Blue Shield plans. (Is our task force available to help on that particular project?)

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Summary of Method for Mortality Fluctuation Reserve

1. Ordinary

A. Assume that t-4 through t are the previous five years. For these five years, determine the following:

$(\text{Risk})_s$ = Average amount at risk in year s.

$(\text{Actual Cost})_s$ = Net mortality cost in year s.

B. Calculate experience mortality rate, q, based on these five years:

$$q = \sum_{s=t-4}^{t} (\text{Risk})_s \div \sum_{s=t-4}^{t} (\text{Cost})_s$$

C. Calculate expected net mortality cost in year t by $(\text{Expected Cost})_t = q \cdot$ (Average amount at risk in year t).

D. Assume that reserve at end of year s is ${}_sV$. Then ${}_tV = \max \{O, {}_{t-1}V + (\text{Expected Cost})_t - (\text{Actual Cost})_t\}$

2. Credit. Each quarter, do the following:

A. Determine incurred claims, M, and earned premiums, P.

B. Determine reserve increment, C, as follows:

$$\text{If} \begin{cases} M \leq K_1 P \\ K_1 P < M \leq K_2 P \\ K_2 P < M \end{cases} \quad \text{then} \quad \begin{cases} C = K_3 P + K_4 (K_1 P - M) \\ C = \min \{ K_3 P_1 K_2 P - M \} \\ C = K_2 P - M \end{cases}$$

C. (Reserve Current quarter) = C + (Reserve prior quarter)

3. Group. Each quarter, do the following:

A. Determine incurred claims, M, and earned premiums, P.

B. Determine reserve increment, C, as follows:

$$\text{If} \begin{cases} M \leq K_1 P \\ K_2 P < M \leq K_2 P \\ K_2 P < M \end{cases} \quad \text{then} \quad \begin{cases} C = K_3 P + K_4 (K_1 P - M) \\ C = \min \{ K_3 P_1 K_2 P - M \} \\ C = K_2 P - M \end{cases}$$

ATTACHMENT M

TO: Mr. John O. Montgomery, Chief Actuary
California Insurance Department

FROM: William A. White, Actuary
New Jersey Department of Insurance
1201 East State St., Trenton, New Jersey 08625

DATE: April 25, 1977

RE: Destrengthening Annuity Reserves

This will be an attempt to record some quick and unrefined reactions to your letter of April 22, 1977 concerning annuity reserve destrengthening and new mortality table construction.

We have been discussing the development of regulations and guidelines for both the retroactive adjustment of existing group annuity reserves to a 5% valuation basis and for new group annuity business valued at 7½%. This is because Prudential has introduced a bill, in the New Jersey Legislature, calling for both changes, and it appears that the bill is likely to be enacted. As to the "5% change," I share much of Ramon Estefania's concern about windfall profits for the companies involved. I had assumed that the purpose of permitting higher valuation rates on existing group annuity business was only to correct the harm done by surplus drains when companies established old blocks of business on reserve bases artificailly and unnecessarily more conservative than the premium assumptions. For this reason, I would prefer to see a limitation on the maximum permissible amount of destrengthening, with the limitation being the unamortized portion of surplus strain encountered when the revalued business was originally put on the books. For instance, I can see no justification for permitting a change in valuation interest assumptions for a block of contracts where both rates and reserves were based on 3½% interest and where no surplus strain was ever encountered. I am also concerned that many companies – in order to minimize surplus strain – may have offset the unduly conservative interest requirements imposed by law with mortality assumptions which were equally unduly optimistic. Any change permitting more realistic interest assumptions should be accompanied by regulatory action to insure that the mortality assumptions are equally realistic.

As to the 7½% interest rate for new group annuity business, we have approached this with great trepidation. Frankly, this scares the hell out of me and we have persuaded Prudential to modify the NAIC model so as to call for stringent regulation. We are concerned with the degree of investment sophistication within companies permitted to use 7½%, the surplus position of these companies (their ability to strengthen if investment yields go sour), the extent of high interest guarantees in contracts sold under this valuation basis, and our ability to react quickly when new money rates drop. I can't help but feel that we are wading in completely uncharted waters and may, at any moment, be over our heads. I have also accused many economists of not being able to distinguish between a straight line and a sine curve, and I was impressed by Jack Bragg's prediction (Presidental Address, October 19, 1976) that "new money interest rates will be lower than the astronomical levels prevailing in the mid-seventies" and that "many 9 percent, 10 percent and 11 percent investments then made will prove beyond the ability of the borrowers to pay in full."

As to the new mortality tables, I formed two distinct impressions at our initial Society meeting in Boston last October. The first impression was that the 1958 CSO Committee, in essence, completely ignored the mortality experience of the twenty or so large companies who regularly contribute to the Society's intercompany mortality studies and derived mortality rates primarily on the basis of data from the 33 companies which submitted statistics for purposes of determining acceptable margins. If the margins are going to be determined to cover, age by age, the tabular costs of some percentage of small companies, then any mortality table may serve as the unloaded starting point to which margins will be applied. I feel that much too much emphasis was placed on this aspect of margin determination, and much too little emphasis was placed on the adequacy of resulting reserve levels.

The second impression I came away with is that most of the recommendations of the Society Committee and of the NAIC during the late fifties tended to produce unrealistically low reserve levels. This is because the level of reserve is much more dependent on the slope of mortality rates than on their magnitude. Any action which serves to flatten the mortality curve depresses reserve levels. Thus, for instance, aggregate or ultimate experience will generate lower reserves than will select experience, and the addition of a constant margin, or, in fact, an increasing margin which increases less rapidly than the reciprocal of the expectation of life, will result in lower reserves than most companies should maintain. There are three somewhat conflicting criteria which the actuaries and regulators are going to have to satisfy:

1. Loaded rates must be such as to produce whole life reserves at least as large as those required by the select mortality experience of companies contributing to the Society's studies;

2. Loaded mortality rates must be sufficient, in the aggregate, to cover the tabular cost requirements (not necessarily year-by-year) of at least 95% of small life companies; and

3. Loaded mortality rates must produce net premiums sufficiently small so that premium costs for nonparticepating life insurance will not be artifically inflated by the necessity to avoid the surplus drains which deficiency reserve requirements would produce.

As I said at the outset, these are quick and unrefined reactions and are not intended to represent a complete development of our problems in either the group annuity interest or ordinary mortality valuation areas. I remain optimistic that we may still be able to get together to explore them at the length from the monumental and splendid job that you and other members of the technical task force have done.

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ATTACHMENT N

American Council on Life Insurance

Memorandum in Support of Lowering the Minimum Reserve Standards for Group Annuities Purchased Prior to the Operative Date of the 1972 Amendments to the Standard Valuation Law by Increasing the Statutory Valuation Interest Rate

In December 1976 the NAIC considered a proposal to increase the statutory valuation interest rate from 3½% to 5% for group annuities purchased prior to the operative date of the 1972 amendments to the standard valuation law. This proposal would reduce minimum reserve standards for these annuities. Such a reduction would recognize the fact that most insurers' interest yields on funds underlying this business are currently in the neighborhood of 6% to 6½%. Moreover, these yields can be expected to remain constant or to rise as interest and principal repayments are reinvested at current and expected future interest rates. At the December NAIC meeting, commissioners requested further information on the rationale for such a change and how the additional flexibility it would provide might be utilized. Guidelines for use in approving any destrengthening of group annuity reserves were also requested. This memorandum is intended to answer these requests.

A reduction in minimum reserve standards for these group annuities would enable insurers to release excessive reserves on closed blocks of group annuity business in a more timely manner. Group annuities purchased prior to the operative date of the 1972 amendments to the standard valuation law constitute a closed and maturing block of business and, in any event, excess reserves for this business will eventually be released. However, to require insurers to maintain excessive reserves distorts emerging earnings patterns and impairs insurers' ability to distribute surplus to contractholders or to write new annuity business. A distortion of earnings patterns in the opposite direction would occur when the business goes off the books and excess reserves are released.

As group annuities approach their payout phase, the reserve redundancies described above will remain even if future new money interest yields decline. Repayments of principal and interest are roughly offset by benefit payments to annuitants so that the average yield on such group annuity business as it matures becomes increasingly immunized from the effects of new money yields.

A number of reasons would require any destrengthening of reserves toward the proposed new minimum standard to be gradually implemented over a period of years. First, such destrengthening would be subject to approval of the insurance commissioner as provided in Section 6 of the standard valuation law. (Attached to this memorandum are proposed guidelines for use by commissioners in evaluating any individual company proposals for such destrengthening.) Second, a qualified actuary is required to give an opinion in the NAIC annual statement blank as to whether reserves "make a good and sufficient provision for all unmatured obligations of the company guaranteed under the terms of its policies." Third, a sudden release of large amounts of reserves into surplus would result in federal income tax consequences severe enough to make such action very unattractive for financial reasons.

During recent periods of high interest rates, insurers who have based dividends to group annuity contractholders on realistic experience factors have had to use general surplus funds to meet statutory reserve requirements. For such companies, the ability to destrengthen reserves for existing group annuities would reduce the strain on general surplus, thus permitting those companies to meet the surplus demands resulting from new group annuity business as it is written. Even under the 1976 NAIC amendments to the standard valuation law surplus strains will arise because minimum reserves for new group annuities will average about 110% of the net premiums used in pricing the benefits. Other companies who have met excessively high statutory reserve requirements by holding back on surplus distribution would, in addition, find the reduced reserve requirements helpful in adjusting their surplus distribution formulas to modern conditions.

The redundancy in reserves for existing group annuities has appeared at a time when some of the largest pension writers have been forced to stop quoting on certain nonparticipating single premium group annuities because large reserve strains result from writing this business at competitive rates. The Employee Retirement Income Security Act of 1974 has created a potentially huge market demand for such business by requiring terminated pension plans to make insured annuity benefits available to participants. ERISA has also created Federal Pension Benefit Guaranty Corporation which can insure these benefits at competitive rates. If private insurers are unable to compete effectively for this business, a large part of the private insurance sector may be lost to the federal government by default.

Questions have been raised as to why the proposal to lower minimum reserve standards should apply only to group annuities and not to other life insurance company products. A broader application of the proposal would not be practical. For most other products reserves are linked to cash values, Which are guaranteed by the terms of the contract. Reserve destrengthening for contracts with guaranteed cash surrender benefits would not be feasible even if minimum reserve standards were to be lowered.

In summary, because of increased interest yields, minimum reserve requirements for the closed blocks of group annuities purchased prior to the operative date of the 1972 NAIC amendments to the standard valuation law have become excessive. Due to the heavy weighting of this business toward annuities which are either in or about to enter their payout phase, the reserves for such benefits can be expected to continue to be excessive until the business runs off the books. A lowering of minimum reserve standards to recognize the higher interest earnings on existing group annuities would place private insurers in a better position to offer competitively priced pension products to the public and to release unneeded funds as dividends or experience rating credits to group pension contractholders. For these reasons, we urge NAIC adoption of the proposal to increase the statutory valuation interest rate from 3½% to 5% for group annuities purchased prior to the operative date of the 1972 NAIC amendments to the standard valuation law.

Proposed Guidelines for Use by Insurance Commissioners in Approving
Any Destrengthening of Group Annuity Reserves Under New Minimum Reserve Standards
for Annuities Purchased Prior to the Operative Date of the 1972 NAIC Amendments
to the Standard Valuation Law

Recommendation 3 of the report of the NAIC Valuation and Nonforfeiture Value Regulation (C3) Technical Task Force which was considered by the NAIC in December, 1976 would amend the standard valuation law to increase from 3½% to 5% the statutory interest rate used in determining minimum reserve standards for group annuities purchased prior to the operative date of the 1972 NAIC amendments to the standard valuation law. This would make it possible for group pension writers to destrengthen reserves for existing group annuities in recognition of the fact that, in most cases, reserves for such annuities based upon a 3½% interest earnings assumption have proved to be redundant. However, any such destrengthening would be subject to the approval of the commissioner as provided in the last paragraph of Section 6 of the standard valuation law which states:

> Any such company which at any time shall have adopted any standard of valuation producing greater aggregate reserves than those calculated according to the minimum standard herein provided may, with the approval of the commissioner, adopt any lower standard of valuation, but not lower than the minimum herein provided.

The purpose of these guidelines is to set forth factors which should be taken into account by a commissioner in approving any reserve destrengthening for existing blocks of group annuities.

1. Requirements for Destrengthening

The commissioner should ask companies who request permission to destrengthen reserves to explain the financial conditions which make it appropriate to hold smaller reserves. Such companies should be prepared to demonstrate that the expected future investment earnings on the funds (actuarial asset shares) supporting the annuities for which reserves are to be destrengthened will be adequate to meet both future minimum reserve requirements and future obligations in relation to expected emerging mortality experience of annuitants. The expected future investment earnings used in the demonstration should be based on the method, either investment-year method or aggregate-portfolio method, actually used by the insurer to allocate investment income to the group annuity line of business. One method for demonstrating the adequacy of destrengthened reserves for annuities is by means of an actuarial projection of the expected fund, reserves and surplus running until most of the annuities have terminated by using realistic assumptions as to future interest earnings, repayment of existing investments and benefit payments with appropriate margins for future uncertainties.

2. Implication of Future Interest Rate Changes for Group Annuities

The financial effect on a company of future fluctuations in interest rates will depend on the relative proportions of immediate annuities and short-term deferred annuities to long-term deferred annuities in force.

Immediate Annuities. An important consideration in any reserve destrengthening is the duration to maturity or reinvestment of the underlying investments associated with the business relative to the duration to maturity of the insurer's contractual obligations. If future cash flows required by benefit payments closely parallel future cash flows generated by interest income and repayments of capital on an insurer's investments, the effect of a change in the rate of future investment earnings on the funds underlying the business should be minimal. Thus, these funds are largely insulated from effects due to future fluctuations in investment yields. For example, in the case of most immediate annuities there is little likelihood of an appreciable change, either upward or downward, in the rate of investment earnings on the underlying funds because most interest and principal repayments are paid out in benefits rather than being reinvested.

Deferred Annuities. With respect to deferred annuities which are within a few years of their payout phase, the effect of reinvestment of future cash flows will be similar to that described for immediate annuities: the effect of a change in the rate of future investment earnings on the funds underlying the business should be minimal. For existing deferred annuities with longer terms to maturity, reinvestment of interest and principal repayments will have an effect whose significance will vary by the length of term to the beginning of the payout period. For a significant period into the future while new money rates exceed the portfolio rates, the rate of return on investments supporting these annuities would be expected to rise. There may be a greater likelihood of dispersion in future interest yields from high new money rates than from lower new money rates. Future yields on funds underlying deferred annuities with longer terms to maturity may fluctuate until these contracts reach their payout phase and thereby become insulated from the effects of yields on new investments.

In most cases, group annuities with longer periods to maturity will constitute only a small portion of existing group annuities.

A company for whom a major proportion of annuities for which reserves are to be destrengthened involve long deferral periods should be prepared to demonstrate that the destrengthened reserves will be sufficient to carry these contracts to maturity in the event of adverse trends in future interest earnings and/or mortality experience.

3. Utilization of Reserves Released

A company who requests permission to destrengthen reserves should estimate the dollar amount of reserve destrengthening and should be able to show that such destrengthening would better enable it to meet its responsibilities to policyholders and the public. For example, where dividends (and/or experience credits) to group annuity policyholders have been lower than otherwise would have been credited in the absence of statutory reserve requirements, less redundant reserves would make possible a larger allocation of distribution surplus. On the other hand, if an insurer has based dividends (and/or experience credits) to group annuity policyholders on realistic experience factors and an appropriate risk reserve, then reserve destrengthening would enable the insurer to absorb surplus strains caused by writing new group annuities that it would otherwise be unable to write.

Technical Corrections
to the
NAIC Individual Deferred Annuities Nonforfeiture Model Law
and to the
NAIC Life Insurance Standard Valuation Model Law
and to the
NAIC Life Insurance Standard Nonforfieture Model Law

(Page references are to the 1977 NAIC Proceedings I.)

(ATTACHMENT A-1. ANNUITIES NONFORFEITURE LAW.)

Page 485-486, Section 4(a)(ii).

(ii) the amount of any indebtedness to the company on the contract, including ~~including~~ interest due and accrued, and increased by any existing additional amounts credited by the company to the contract.

Contract

The net considerations for a given ~~contarct~~ year used to define the minimum nonforfeiture amount shall be an amount not less than zero and shall be equal to the corresponding gross considerations credited to the contract during the contract year less ~~than~~ an annual contract charge of thirty dollars ($30.00) and less a collection charge of one dollar and twenty-five

Cents

($1.25) per consideration credited to the contract during that contract year. The percentages of net considerations shall be sixty-five percent (65%) of the net consideration for the first contract year and eighty-seven and one-half percent (87½%) of the net considerations for the second and later contract years. Notwithstanding the provisions of the preceding sentence, the percentage shall be sixty-five percent (65%) of the portion of the total net consideration for any renewal contract year which exceeds by not more than two times the sum of those portions of the net considerations in all prior contract years for which the percentage was sixty-five percent (65%).

Page 486, Section 4(b)(2).

(2) The annual contract charge shall be the lesser of (i) thirty dollars ($30.00) or (ii) ten percent (10%) of the gross annual consideration~~s~~.

Page 486, Section 7.

7. For contracts which do not provide cash surrender benefits, the present value of any paid-up annuity benefit available as a nonforfeiture option at any time prior to maturity shall not be less than the present value of that portion of the maturity value of the paid-up annuity benefit provided under the contract arising from considerations paid prior to the time the contract is surrendered in exchange for, or changed to, a deferred paid-up annuity, such present value being calculated for the period prior to the maturity date on the basis of the interest rate specified in the contract for accumulating the net considerations to determine such maturity value, and increased by any existing additional amounts credited by the company to the contract. For contracts which do not provide any death benefits prior to the commencement of any annuity payments, such present values shall be calculated on the basis of such ~~in~~ interest rate and the mortality table specified in the contract for determining the maturity value of the paid-up annuity benefit. However, in no event shall the present value of a paid-up annuity benefit be less than the minimum nonforfeiture amount at that time.

Page 487, Sections 11 and 12.

11. For any contract which provides, within the same contract by rider or supplemental contract provision, both annuity benefits and life insurance benefits that are in excess of the greater of cash surrender benefits or a return of the gross considerations with interest, the minimum nonforfeiture benefits shall be equal to the sum of the minimum nonforfeiture benefits for the annuity portion and the minimum nonforfeiture benefits, if any, for the life insurance portion computed as if each portion were a separate contract. Notwithstanding the provisions of

Sections 5, 6, 7, 8 and 10, additional benefits payable (a) in the event of total and permanent disability, (b) as reversionary annuity or deferred reversionary annuity benefits, or (c) as other policy benefits additional to life insurance, endowment and annuity benefits, and considerations for all such additional benefits, shall be disregarded in ascertaining the minimum nonforfeiture amounts, paid-up annuity, cash surrender and death benefits that may be required by this ~~Section.~~ Act. The inclusion of such additional benefits shall not be required in any paid-up benefits, unless such additional benefits separately would require minimum nonforfeiture amounts, paid-up annuity, cash surrender and death benefits.

12. After the effective date of this Act, any company may file with the commissioner a written notice of its election to comply with the provisions of this Act after a specified date before the second anniversary of the effective date of this Act. After the filing of such notice, then upon such specified date, which shall be the operative date of this ~~Section~~ Act for such company, this Act shall become operative with respect to annuity contracts thereafter issued by such company. If a company makes no such election, the operative date of this ~~Section~~ Act for such company shall be the second anniversary of the effective date of this Act.

ATTACHMENT A-2. STANDARD VALUATION LAW.

Page 487, Section 2.

2. The commissioner shall annually value, or cause to be valued, the reserve liabilities (hereinafter called reserves) for all outstanding life insurance policies and annuity and pure endowment contracts of every life insurance company doing business in this state, and may certify the amount of such reserves, specifying the mortality table or tables, rate or rates of interest, and methods (net level premium method or other) used in the calculation of such reserves. In calculating such reserves, he may use group methods and approximate averages for fractions of a year or otherwise. In lieu of the valuation of the reserves herein required of any foreign or alien company, he may accept any valuation made, or caused to be made, by the insurance

supervisory official of any state or other jurisdiction when such valuation complies with the minimum standard herein provided and if the official of such state or jurisdiction ~~when such valuation complies with the minimum standard herein provided and if the official of such state or jurisdiction~~ accepts as sufficient and valid for all legal purposes the certificate of valuation of the commissioner when such certificate states the valuation to have been made in a specified manner according to which the aggregate reserves would be at least as large as if they had been computed in the manner prescribed by the law of that state or jurisdiction.

Page 488, Section 3.

3. Except as otherwise provided in Section three-a, the minimum standard for the valuation of all such policies and contracts issued prior to the effective date of this Act shall be that provided by the laws in effect immediately prior to such date. Except as otherwise provided in Section three-a, the minimum standard for the valuation of all such policies and contracts issued on or after the effective date of this Act shall be the Commissioners reserve valuation methods defined in Sections four, four-a and seven, three and one-half percent (3½%) interest, or in the case of policies and contracts, other than annuity and pure endowment contracts, issued on or after (insert effective date of 1972 NAIC Amendments to the Standard Valuation Law) ~~the effective date of this amendatory Act of 197 – and prior to January 1, 1986~~, four percent (4%) interest for such policies issued prior to the effective date of this amendatory Act of 197 , five and one-half percent (5½%) interest for single premium life insurance policies and four and one-half percent (4½%) interest for all other such policies issued on or after the effective date of this amendatory Act of 197 , and the following tables:

Page 489, Section 3-a (e).

~~(d)~~(e) For all annuities and pure endowments purchased on or after the effective date of this amendatory act of 197 under group annuity and pure endowment contracts, excluding any disability and accidental death benefits purchased under such contracts, – the 1971 Group Annuity Mortality Table, or any modification of this table approved by the Commissioner, and seven and one-half percent (7½%) interest.

For all annuities and pure endowments purchased on or after January 1, 1990 ~~1986~~ under group annuity and pure endowment contracts, excluding any disability and accidental death benefits purchased under such contracts -- the 1971 Group Annuity Mortality Table, or any modifications of this table approved by the Commissioner, and ~~three~~ six ~~and one-half~~ percent ~~(3½%)~~ (6%) interest.

Page 491, Section 7.

7. If in any contract year the gross premium charged by any life insurance company on any policy or contract is less than the valuation net premium for the policy or contract calculated ~~according to the mortality table, rate of interest, and~~ by the method used in calculating the reserve thereon but using the minimum valuation standards of mortality and rate of interest, ~~there shall be maintained on such policy or contract a deficiency reserve in addition to all other reserves required by law. For each such policy or contract, the deficiency reserve shall be the present value, according to such standard of an annuity of the difference between such net premium and the premium charged for such policy or contract running for the remainder of the premium paying period,~~ the minimum reserve required for such policy or contract ~~is~~ Shall be the greater of either the reserve calculated according to the mortality table, rate of interest, and method actually used for such policy or contract, or the reserve calculated by the method actually used for such policy or contract but using the minimum standards of mortality and rate of interest and replacing the valuation net premium by the actual gross premium in each contract year for which the valuation net premium exceeds the actual gross premium.

(ATTACHMENT A-3. STANDARD NONFORFEITURE LAW.)

Page 491, Amending Section 5 b, first sentence.

5b. In the case of Industrial policies issued on or after the operative date of this Section five-b as defined herein, all adjusted premiums and present values referred to in this Act shall be calculated on the basis of the Commissioners 1961 Standard Industrial Mortality Table and the rate of interest specified in the policy for calculating cash surrender values and paid-up nonforfeiture benefits provided that such rate of interest shall not exceed three and one-half percent (3½%) per annum, except that a rate of interest not exceeding four percent (4%) per annum may be used for policies issued on or after (insert effective date of 1972 NAIC Amendments to the Standard Nonforfeiture Law) ~~the effective date of this amendatory Act of 197 and prior to January 1, 1986~~ and prior to the effective date of this amendatory Act of 197 and a rate of interest not exceeding five and one-half (5½%) per annum may be used for policies issued on or after the effective date of this amendatory act of 197 , except that for any single premium whole life or endowment insurance policy ~~at~~ a rate of interest not exceeding six and one-half percent (6½%) per annum may be used.

Agents Compensation Task Force

Minneapolis, Minnesota
June 6, 1977

The Agents Compensation Task Force met Monday, June 6, 1977 at the Radisson Hotel in Minneapolis, Minnesota. Those present included Thomas J. Kelly, New York; Ted Becker, Texas; Harry V. Jump, Ohio Insurance Commissioner; J. Ramon Estefania, South Carolina; and Erma Edwards, Nevada. The task force was appointed in 1974 with the charge to conduct a study of agents' compensation systems to determine the impact which the compensation structures have on the sale of various classes of life products.

The task force has now received two reports from its industry advisory committee. The first report has been printed in 1976 NAIC Proceedings II 558. The second was submitted to the task force at this meeting.

The advisory committee's first report provided the task force with a detailed history of development in agents' compensation as well as an elaborate review of the innumerable systems currently in use. Attached to the report is an exhibit illustrating the different types of compensation programs by type of producer, including all forms of direct compensation as well as security benefits and sales support payments. This report also reviews the several expense limitation statutes in existence.

In addition, the advisory committee provided the task force with substantial information on agents' earnings and expenses. This section of the report also included information on the comparative starting salaries (under financing plans) of new agents and other college graduate positions. The studies cited in the report indicate that business expenses approximate one-third of total earnings.

The second report provides additional data on agents' earnings from a diverse group of companies highlighting both inter-company differences as well as the mean/median gap within companies.

Finally, both reports provided insight into the question posed in the original charge to the task force.

The task force will review and evaluate the materials available, including the reports of the advisory committee, to determine if further information is needed.

The task force plans to have a report of the completed study for the December meeting together with recommendations for any further action.

Thomas J. Kelly, New York; Ted Becker, Texas; Harry V. Jump, Ohio Insurance Commissioner; J. Ramon Estefania, South Carolina; Erma Edwards, Nevada.

Second Report of the Industry Advisory Committee to the Agents' Compensation Systems Task Force

June 6, 1977

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Formation of the Advisory Committee

The genesis of this study goes back to December of 1973 at the annual NAIC meeting in Las Vegas when the Life Insurance (C3) Subcommittee determined that it would establish four task forces to conduct separate studies of different aspects of the life insurance industry. A study of agents' compensation systems to determine the impact which compensation structures have on the sale of various classes of life products was delineated as one of the areas for examination. Subsequently, in April, 1974, the "Task Force to Study Life Agents' Compensation Systems" consisting of seven insurance commissioners was appointed. Only two of the original seven commissioners remain on the committee. At the June, 1974 meeting a brief report of the task force to the Life Insurance (C3) Subcommittee indicated that:

> The subject of study should include the expense limitation statutes and the feasibility of adopting a model statute covering expense limitation. This task force shall therefore limit itself to the study of life agents' compensation systems, and no other, with the thought in mind as to what impact the compensation methods have on the sale of the various classes of life products. The task force must at the beginning limit itself to the existing system and not at first be as much interested in a change of the system. Any effort at this time to consider reform would dilute the group's ability to completely apprehend and clearly define the existing system's impact on the delivery of the product.

The report also indicated that an industry advisory committee would be formed. Superintendent Farmer of Missouri, then task force chairman, appointed the industry advisory committee in August, 1974. In selecting advisory committee members every effort was made to see that each segment of the industry was represented both geographically and with respect to marketing delivery systems. In addition to company representation, the advisory committee includes representatives of the American Life Insurance Association (ALIA), the National Association of Life Underwriters (NALU) and the Life Insurance Marketing and Research Association (LIMRA), as well as a representative from academia.

The organizational meeting of the industry advisory committee was held in Kansas City on September 4, 1974, jointly with the task force itself. At this meeting, it was agreed that our efforts should be concentrated on compensation associated with the sale of individual life products thereby eliminating from our study group insurance as well as compensation in the accident and sickness areas. It was also agreed that attention need not be focused on combination agents selling industrial life insurance since no one seemed to think there were many problems in this area dealing with agents' compensation. At this first meeting, it also became readily apparent that our initial efforts would have to be concentrated on the existing system of agents' compensation since little could be accomplished without a thorough understanding of what the existing system is.

It was agreed that one or more representatives of the NAIC task force would attend each of the industry advisory committee meetings. Subsequent meetings of the full industry advisory committee were held in St. Louis in November, 1974 and in New Orleans in April, 1975. A report drafting group was then formed which met at Hiltonhead in August 1975 and in Atlanta in October. Thereafter, informal ad hoc groups working on different segments of the report met in February, March and April, 1976. Full committee meetings followed in May and June in order to finalize our first report for submission to the task force at the NAIC meeting. One or more representatives of the NAIC attended each meeting of the full committee and of the report drafting group with the major contribution being made by Ramon Estefania, Chief Actuary of the South Carolina Department. The first report is dated June 6, 1976 and is printed in the 1976 Proceedings of the NAIC, Vol. II at page 558.

In preparing for the industry advisory committee's first report, it studied the existing compensation structure, expense limitation statutes, the impact of compensation on sales and product mix, income and expense of life agents, agents' compensation systems as compared with other retail sales structures, a review of advertising practices that may relate to agents' compensation, as well as an examination of so-called "specialty" products. In the course of this examination, most major companies were surveyed with respect to some of their current compensation practices and two questionnaires were developed concerning the reasons why an agent places business with or transfers to another company with emphasis on the impact of "specialty" products.

At the time the first report was prepared some of the survey data had not been received. In addition, further research was being undertaken by the Life Insurance Marketing and Research Association (LIMRA) concerning agents earnings and the impact New York's expense limitation statute might have upon commission scales. This second report contains the information now available in these areas.

The Mythology of Agents' Earnings

Summary of First Report Findings

Following a detailed analysis of the various agents' compensation systems being utilized in this country (which was the principal assignment of the industry advisory committee) and a brief explanation of the several expense limitation laws, the first report reviewed existing data concerning agents' gross and net incomes. At the outset, it was pointed out that agents' income was either "too high" or "too low" depending upon the particular bias of the person being asked. Some misconceptions as to agents' earnings appeared to stem from the premise that all agents were as "successful" as one's own agent seemed to be. In other instances, it appeared that a conception of "high earnings" resulted from the knowledge that the agents' first year commission approximated half of the first year's premium without any attempt to relate commissions to total product cost.

This seemed particularly true as comparisons were made with those selling real estate, automobiles or other consumer products without regard for differences in selling expenses, service expectations or the relationship between commissions and total product cost. Indeed, some of the misconceptions seemed to be shared by those tolerably familiar with our industry, as well as the public at large.

In 1972 a survey sponsored by the Institute of Life Insurance indicated that well over 50% of those surveyed thought agents' commissions were substantially higher than reality with the median estimate being approximately double what actual commissions were on the test question.

Citing 1971 and 1973 data, the first report showed that half of the experienced career agents of United States companies earned first year commissions of $5,439 or less with their primary company and one-quarter earned first year commissions of $2,547 or less. Since it was estimated that experienced agents' first year commissions represent over half of their total income, these figures were significant. Furthermore, 1973 total personal income data showed that 39% of agents with one to three year's experience earned less than $10,000 and that an additional 24% with three to five year's experience earned under that figure.

A comparison of beginning job salaries for candidates with a bachelor's degree also showed that new agents ranked fairly low on the starting salary totem pole. This information, based upon the College Placement Council's Salary Survey of 1974, highlighted the gulf between new agents and the very successful big producers – a characteristic of compensation based upon sales which is not peculiar to the life insurance industry. This characteristic was highlighted further by differences in average and median earnings where such information was available.

Finally, the Million Dollar Round Table's expense study showed that approximately one-third of agents' earnings went to pay expenses illustrating the fairly wide margin between gross and net earnings for people in this business.

While much of the information in this section of the first report is being updated or expanded upon below, the reader should review the background material in the first report in order to better appreciate its significance.

NALU/LIMRA Survey of Agency Opinion

In the Summer of 1976 the NALU and LIMRA conducted its joint biannual survey of agency opinion sent to approximately 9,000 NALU members on a random basis. There were 2,822 replies received from full time agents, supervisors, and others. From the information gathered in this survey, some overall information was gathered with respect to 1975 total personal income of 799 full time ordinary U. S. agents. For this purpose, full time ordinary agents are defined as those: (1) in business at least one year, (2) on the job for a full twelve months in 1975, (3) not involved in selling weekly or monthly premium debit insurance in 1975, (4) not from a multiple-line exclusive agent company, (5) where at least 75% of total earned personal income came from the sale of individual or group, life, fixed annuity, variable annuity, mutual funds, equity linked contracts and health insurance; and (6) where at least 50% of total earned personal income came from the sale of individual life and annuities.

The table below sets forth the distribution of agents within various income levels based upon their years of service and the percentage of income earned in the sale of individual life insurance and annuities. This table may be compared with that contained in the first report based upon 1973 data.

1975 Personal Income of Full Time Ordinary U. S. Agents

A. Agents with 75-100% of their income from the sale of individual life insurance and/or annuities.

	1975 Total Personal Income					
Time in Business	Less Than $10,000	$10,000-$14,999	$15,000-$19,999	$20,000-$24,999	$25,000+	Total
1-3 Years	17%	32%	26%	15%	10%	100%
3-5 Years	14	32	22	20	12	100%
5 Years +	2	9	17	17	55	100%

B. Agents with 50-74% of their income from the sale of individual life insurance and/or annuities.

Time in Business	1975 Total Personal Income Less Than $10,000	$10,000-$14,999	$15,000-$19,999	$20,000-$24,999	$25,000+	Total
1-3 Years	11%	42%	26%	21%	0%	100%
3-5 Years	11	21	29	18	21	100%
5 Years +	1	7	15	15	62	100%

While the 1975 figures show a significant improvement in the income levels for agents in their first five years in the business, it must be remembered that the period between 1973 and 1975 reflected a substantial increase in the cost of living. Notwithstanding this improvement, however, for those agents deriving between 75% and 100% of their income from the sale of individual life insurance and annuities, some 17% of those in their first three years and 14% of those in years three to five had gross earnings of less than $10,000.

LIMRA Manpower and Production Survey

In December 1976 LIMRA published the results of its manpower and production survey for the calendar year 1975. Information pertaining to the 1975 total agent earnings from each reporting company is set forth in the table below. Although the information is available, the table excludes data on commissions generated for agents within their first three years since that group generally receives some form of salary under a financing arrangement and there is no necessary relationship between commissions generated and earned income. This data is based upon a grouping of 36 United States and 16 Canadian companies contributing to the survey. The information on total earnings is not printed in the LIMRA publication but is derived from information submitted in connection with the survey described above.

Total 1975 Earnings* Per Agent by Calendar Year of Service

Years of Service	Average	Median	First Quartile	Third Quartile
Fourth Year	11,233	9,398	6,240	14,357
Fifth and Over	20,355	14,781	8,591	Over $20,000

Distribution of Agents According to their Total 1975 Earnings*

Years of Service	Under $6,000	$6,000-$11,999	$12,000-$19,999	$20,000+
Fourth Year	23%	42%	24%	11%
Fifth and Over	15%	24%	26%	35%

* First year and renewal commissions and bonuses on all individual and group business, but excluding financing and training allowance payments.

In addition to the aggregate data on the 52 companies contained in the above table, information was obtained from nine individual companies based upon 1976 data which will be used in preparing the next manpower and production survey. Again, these tables deal with total agent earnings from the reporting company excluding financing and trading allowances. Since information on only one company was specifically identified in the first report, the following information should provide the reader with a better perspective as to differences among companies.

Total 1976 Earnings* from All Insurance Sources for Selected Agent Experience Categories

A Medium-sized Midwestern Stock Company

Years in Business	Median Earnings	Average Earnings
4 Years	$10,571	$10,723
5-9 Years	17,688	19,480
10-14 Years	19,214	19,941
15-19 Years	22,395	24,387
20 Years +	19,000	24,478

A Medium-sized Midwestern Mutual Company

Years in Business	Median Earnings	Average Earnings
4 Years	$10,500	$13,438
5-9 Years	14,750	17,228
10-14 Years	17,286	17,315
15-19 Years	20,188	22,558
20 Years +	20,500	18,834

A Large Northeastern Mutual Company

Years in Business	Median Earnings	Average Earnings
4 Years	$ 9,577	$11,375
5-9 Years	13,832	17,423
10-14 Years	19,715	24,152
15-19 Years	17,800	25,352
20 Years +	20,091	28,130

A Medium-sized Southwestern Stock Company

Years in Business	Median Earnings	Average Earnings
4 Years	$12,000	$13,573
5-9 Years	14,857	17,273
10-14 Years	14,000	15,484
15-19 Years	26,071	24,291
20 Years +	15,250	21,766

A Medium-sized Midwestern Mutual Company

Years in Business	Median Earnings	Average Earnings
4 Years	$ 7,250	$ 9,619
5-9 Years	11,400	16,615
10-14 Years	16,643	21,592
15-19 Years	23,500	31,268
20 Years +	16,900	25,162

A Medium-sized Southern Mutual Company

Years in Business	Median Earnings	Average Earnings
4 Years	$ 9,500	$10,468
5-9 Years	11,556	12,964
10-14 Years	14,000	17,961
15-19 Years	11,333	14,218
20 Years +	12,000	15,211

A Medium-sized Northeastern Mutual Company

Years in Business	Median Earnings	Average Earnings
4 Years	$21,143	$25,016
5-9 Years	26,875	36,345
10-14 Years	25,000	35,113
15-19 Years	17,286	23,112
20 Years +	11,333	19,458

A Small Western Mutual Company

Years in Business	Median Earnings	Average Earnings
4 Years	$16,000	$14,635
5-9 Years	15,200	19,439
10-14 Years	20,846	21,179
15-19 Years	24,100	25,214
20 Years +	16,000	22,087

A Small Southern Stock Company

Years in Business	Median Earnings	Average Earnings
4 Years	$ 7,000	$ 9,065
5-9 Years	10,800	13,207
10-14 Years	14,000	17,102
15-19 Years	18,500	20,547
20 Years +	16,000	20,618

* First year and renewal commissions and bonuses on all Individual and group business, but excluding financing and training allowance payments.

The companies represented in the table above were selected to give examples of both large and small and stock and mutual representation with some geographical dispersion. For purposes of this classification companies were graded by size as follows: large – four billion or more of insurance in force, medium – between one and four billion of insurance in force, small – less than 1 billion in force. Note the substantial differences in some instances between a company's average and median figures for any category, as well as the differences between companies. Keep in mind, however, that some of the differences between companies are due to factors other than agent productivity. Commission rates differ across companies, as does the mix of business. In addition, companies compensate in other ways than pure commissions, such as through fringe benefits and reimbursement for business expenses. See the first report and accompanying exhibits for a detailed description of the various compensation systems in use.

As far as compensation for combination agents is concerned, 1975 information is also available. In preparing their 1975 vital statistics for combination companies in conjunction with the manpower and production survey, the reporting companies were asked to submit the average weekly income for each of the following categories: manager, assistant manager, agent with one year or more of service ("established agent"), and agent with less than one year of service ("new agent"). The companies are classified into three size groups according to the number of debits that the company has: large companies – 1,400 or more debits; medium companies – 500 to 1,399 debits; and small companies – under 500 debits.

Median Weekly Income

	1975				1974			
	Mgr.	Assistant Mgr.	New	Agent Established*	Mgr.	Assistant Mgr.	New	Agent Established*
Large	$456	$274	$186	$221	$447	$276	$179	$208
Medium	367	251	180	219	374	257	175	212
Small	362	258	186	215	329	257	175	199
All	$382	$261	$181	$216	$366	$263	$175	$202
Number of Companies	51	51	19	51	55	55	25	55

* Includes 16 companies that gave average weekly income for all agents for 1975 and 18 companies that did so for 1974. Excluding these companies, the medians are:

	1975	1974
Large	$264	$237
Medium	222	215
Small	228	213
All	$226	$215

In general, among the three size groups, the 1975 median income for agents shows some increase over the previous year, whereas the 1975 median income for assistant managers is just about the same as in the preceding year. The all-company median income figure for 1975 for managers is higher than in 1974 largely because of increases for managers in small companies, whose median income increased 10 percent in 1975.

The Task Force Questions

In its first report to the Life Insurance (C3) Subcommittee, the task force listed six questions to which answers would be sought during the course of their study. The advisory committee in its first report to the task force attempted to respond to these questions although several of them are extremely broad, involving various assumptions and of necessity would appear to dictate a subjective response not supportable by existing data. On the other hand, the first report provided substantial data with respect to a number of questions which should give the task force greater insight as to the answers. When the first report was presented, it was indicated that additional information would be forthcoming with respect to questions 3 and 4 as soon as that information had been compiled. That additional information is set forth below following the question to which it relates.

Question 3

Does competition among insurers for agents lead to the proliferation of policy forms or competitive gimmickry more for the purpose of enticing agents away from other insurers than for serving the needs of life insurance consumers?

In attempting to answer this question, the advisory committee initiated some original research as to the influence so-called "specialty products" had in getting agents to place business with other than their primary company or to switch companies. Based upon information received from members of the task force, "specialty products" were defined to include deposit term, modified premium whole life, split life, etc.

It was decided to construct a questionnaire to ge to both general agents and branch managers, as well as to agents to ask for reasons for agents leaving their primary company or for placing business with another company. The first report contains the survey results from the General Agents and Managers Conference (GAMC). That survey got the answers to the survey question as viewed through the eyes of the general agent or manager. The results indicated that "rating" by the primary company was the principal reason for placing business elsewhere, with "specialty products," "lower going in cost," "better overall product" and higher commission rates being ranked in descending order thereafter.

LIMRA was then asked to include one of these same questions in their 1976 survey of agency opinion (See NALU/LIMRA Survey of Agency Opinion, above) to determine how the GAMC results compared with the questionnaire posed to the people actually placing the business elsewhere.

The majority of full time agents answering this question replied that they placed all their business with their primary company: 55% of the ordinary agents, 91% of combination agents and 91% of multiple line agents – a total of 970 agents. For the 400 who ranked their reasons for placing business elsewhere, it is remarkable that the results on this survey for agents is practically identical to the perception of the general agents and managers. The first five rankings by agents are identical with those indicated by general agents and managers. Consequently, in each survey "specialty products" were given as a reason for placing business elsewhere as a second most significant factor. The complete agents' response to that question is set forth below:

> What were your three main reasons for placing this individual life business with companies other than your primary company? Rank the top three, placing a "1" beside your most important reason, a "2" beside the next most important reason, and a "3" beside the third most important.

	Rank 1	Rank 2	Rank 3	Total
1. Other company's better overall product	38	26	35	99
2. Other company's lower going-in cost	37	51	42	130
3. Other company's lower net ("traditional") cost	10	14	16	40
4. Other company's low interest-adjusted cost	1	1	3	5
5. Prospect rated by primary company	190	62	19	271
6. Specialty products (deposit term, modified premium, whole life, split life, etc.)	55	75	35	165
7. Other company's better sales support	2	12	9	23
8. To qualify for convention, contest, or bonus in other company	0	2	3	5
9. Other company's higher commission rates	11	13	26	50
10. Other company's commission schedule fits my needs better	0	1	2	3
11. Other company's better dividend scale	1	6	1	8
12. Other company's better early cash value	0	5	4	9
13. Other company's total cash value	1	3	2	6
14. Agency head of other company is a close friend of mine	0	6	9	15
15. Other ________________	53	20	20	93

While "specialty products" figured high in both surveys, note that commission rates ranked a distant fifth on each survey subordinate to the product's "lower going-in cost" and the qualitative factor of "better overall product."

Question 4

Where statutory or regulatory constraints are placed upon insurers as regards expenses, a la Section 213 in New York, are bulges created in other lines, such as accident and health?

In the first report, the preliminary conclusion was reached that New York's expense limitation law did not create a life commission rate bulge in accident and health insurance sold in that state. However, that conclusion was based upon an analysis of solely first year commissions and not the total commission scale.

Set forth below are tables comparing the median and mean commissions for New York and non-New York accident and health policies on a 10 and 30 year present value basis at a 60 and 70% persistency. Following these illustrations are four additional tables based on the same assumptions but showing a present value commission distribution by a more detailed classification. Present values are computed at a 6% interest factor.

MEDIAN

Non-New York

	70% Persistency		60% Persistency	
Policy	10 Years	30 Years	10 Years	30 Years
Hospital Indemnity	64.5	76.4	54.9	63.6
Hospital and Surgical	60.2	82.5	50.8	67.6
Major Medical	65.0	79.8	54.7	67.4
Disability Income				
Noncancelable	69.5	80.4	60.2	69.5
Guaranty Renewable	68.4	82.7	58.6	70.2

New York

	70% Persistency		60% Persistency	
Policy	10 Years	30 Years	10 Years	30 Years
Hospital Indemnity	61.8	74.7	53.1	62.3
Hospital and Surgical	59.1	70.6	49.5	58.8
Major Medical	61.6	73.1	53.3	62.1
Disability Income				
Noncancelable	70.9	85.8	61.6	72.3
Guaranteed Renewable	67.4	78.0	58.3	66.0

MEAN

Non-New York

	70% Persistency		60% Persistency	
Policy	10 Years	30 Years	10 Years	30 Years
Hospital Indemnity	65.8	79.7	55.9	66.5
Hospital and Surgical	60.0	76.5	50.5	63.1
Major Medical	61.1	76.7	51.7	63.5
Disability Income				
Noncancelable	68.5	81.5	59.0	68.9
Guaranteed Renewable	68.8	83.8	59.2	70.6

New York

Policy	70% Persistency 10 Years	70% Persistency 30 Years	60% Persistency 10 Years	60% Persistency 30 Years
Hospital Indemnity	59.4	74.7	50.4	62.1
Hospital and Surgical	56.7	68.3	48.0	56.9
Major Medical	59.5	70.7	50.6	59.2
Disability Income				
Noncancelable	72.4	84.3	62.4	71.4
Guaranteed Renewable	65.1	76.3	56.1	64.6

PRESENT VALUE FOR 10 YEARS AT 70% PERSISTENCY

	Non-New York					New York				
	Less Than 60%	60-65	More Than 65%	Total	No. of Cos.	Less Than 60%	60-65	More Than 65%	Total	No. of Cos.
Health										
Hospital Indemnity	.19	.33	.48	1.00	21	.33	.56	.11	1.00	9
Hospital and Surgical	.36	.28	.36	1.00	25	.62	.23	.15	1.00	13
Major Medical	.30	.20	.50	1.00	20	.41	.29	.29	1.00	17
	Less Than 65%	65-70	More Than 70%	Total	No. of Cos.	Less Than 65%	65-70	More Than 70%	Total	No. of Cos.
Disability Income										
Noncancelable	.22	.30	.48	1.00	27	.16	.24	.60	1.00	25
Guaranteed Renewable	.17	.44	.39	1.00	18	.12	.63	.25	1.00	8

PRESENT VALUE FOR 30 YEARS AT 70% PERSISTENCY

	Non-New York					New York				
	Less Than 75%	75-80	More Than 80%	Total	No. of Cos.	Less Than 75%	75-80	More Than 80%	Total	No. of Cos.
Health										
Hospital Indemnity	.43	.14	.43	1.00	21	.56	.33	.11	1.00	9
Hospital and Surgical	.40	.08	.52	1.00	25	.69	.08	.23	1.00	13
Major Medical	.35	.20	.45	1.00	20	.53	.18	.29	1.00	17
	Less Than 80%	80-85	More Than 85%	Total	No. of Cos.	Less Than 80%	80-85	More Than 85%	Total	No. of Cos.
Disability Income										
Noncancelable	.41	.22	.37	1.00	27	.36	.12	.52	1.00	25
Guaranteed Renewable	.33	.28	.39	1.00	18	.50	.12	.38	1.00	8

PRESENT VALUE FOR 10 YEARS AT 60% PERSISTENCY

	Non-New York					New York				
	Less Than 50%	50-55	More Than 55%	Total	No. of Cos.	Less Than 50%	50-55	More Than 55%	Total	No. of Cos.
Health										
Hospital Indemnity	.19	.33	.48	1.00	21	.22	.78	0	1.00	9
Hospital and Surgical	.36	.32	.32	1.00	25	.54	.31	.15	1.00	13
Major Medical	.30	.25	.45	1.00	20	.30	.35	.35	1.00	17
	Less Than 55%	55-60	More Than 60%	Total	No. of Cos.	Less Than 55%	55-60	More Than 60%	Total	No. of Cos.
Disability Income										
Noncancelable	.22	.30	.48	1.00	27	.16	.24	.60	1.00	25
Guaranteed Renewable	.17	.50	.33	1.00	18	.12	.75	.13	1.00	8

PRESENT VALUE FOR 30 YEARS AT 60% PERSISTENCY

	Non-New York					New York				
	Less Than 60%	60-65	More Than 65%	Total	No. of Cos.	Less Than 60%	60-65	More Than 65%	Total	No. of Cos.
Health										
Hospital Indemnity	.28	.24	.48	1.00	21	.22	.56	.22	1.00	9
Hospital and Surgical	.36	.12	.52	1.00	25	.54	.23	.23	1.00	13
Major Medical	.30	.15	.55	1.00	20	.41	.24	.35	1.00	17
	Less Than 65%	65-70	More Than 70%	Total	No. of Cos.	Less Than 65%	65-70	More Than 70%	Total	No. of Cos.
Disability Income										
Noncancelable	.33	.26	.41	1.00	27	.24	.24	.52	1.00	25
Guaranteed Renewable	.28	.22	.50	1.00	18	.50	.12	.38	1.00	8

These figures seem to clearly confirm the assumption in the first report answering the question posed in the negative.

Conclusion

While any of the information contained in the first report or this second report can be updated periodically, if desired, the advisory committee has provided about as much information as is practically available in the absence of further requests or direction from the task force. The only additional work currently in process relates to an exploration of some of the problems that might attend the adoption of some form of mandatory commission vesting as has been suggested from time to time.

One of the major assignments of the task force was to explore what agents compensation systems were currently in use. The first report covers this subject in great detail. In addition, the advisory committee's work provides answers to the questions posed to the extent that answers were supportable by reasonably available objective data. The advisory committee stands ready to assist the task force in whichever way it can. In this respect the advisory committee awaits whatever further guidance or instruction the task force determines to be necessary following their evaluation of the first and second reports.

Life Insurance Replacement Regulation (C3) Task Force
Minneapolis, Minnesota

June 6, 1977

Since the December, 1976 meeting of the NAIC in Phoenix, Arizona, the Life Insurance Replacement Regulation Task Force has appointed an industry advisory committee and met in Omaha, Nebraska to discuss changes in draft no. 1 of the proposed revised model replacement regulation.

The members of the industry advisory committee are: John J. Jaskot, J. Steven Beckman, H. Daniel Gardner, William R. Toler, Carl T. Barnes, Ronald Doane, John States, Don Leising, James Douds, William M. Symon Jr., Edward Jackson, Mike Monette, Jack Bobo and John Jex.

The meeting of the task force to discuss the redraft of the replacement regulation was held Thursday, March 24, 1977 at the Holiday Inn, 72nd and Grover Streets, Omaha, Nebraska. The states of Nebraska, Missouri and Nevada were represented at the task force meeting. Proposed changes to the first draft were discussed along with comments submitted subsequent to the December meeting in Phoenix, Arizona. It was decided that a second draft should be prepared by the Nebraska Department of Insurance and submitted to the industry advisory committee for their comment prior to the June 1977 meeting in Minneapolis, Minnesota. This was completed and draft no. 2 is attached to this report.

A joint meeting of the task force and the industry advisory committee was held on Sunday, June 5, 1977 in Minneapolis, Minnesota at which time the task force heard comments from the industry advisory committee concerning proposed changes to draft no. 2 of the proposed revised model replacement regulation. The task force then went into executive session to discuss the comments and additional changes. The industry advisory committee was charged with the responsibility of drafting a new revised Exhibit B to the model regulation (not yet available) for review by the task force as well as submitting to the task force proposed formats for disclosing pertinent information concerning annuities and variable products on the disclosure form. It is the intention of the task force to meet early this fall prior to preparing a third draft of Exhibit A.

Hon. M. Berri Balka, Chairman, Nebraska; Hon. Jerry B. Buxton, Missouri; Hon. H. Pete Hudson, Indiana; Hon. Dick L. Rottman, Nevada; Hon. Clifton N. Ottosen, Utah.

Second Draft

Proposed Revised
Model Life Insurance Replacement Regulation

Section 1. Statutory Authority.

This regulation is promulgated by the insurance _______________ pursuant to Section__________ of the insurance laws of _______________, which authorizes the insurance _______________ to make all reasonable rules and regulations to administer the insurance laws of _______________.

Section 2. Purpose.

The purpose of this regulation is:

(1) To implement the insurance laws of_______________ by regulating the acts and practices of insurers and agents with respect to life insurance replacing life insurance under Sections__________ and __________ of the insurance laws of _______________.

(2) To protect the interests of the life insurance public by establishing minimum standards of conduct to be observed in the replacement ~~or proposed replacement~~ of life insurance policies; by making available full and clear information on which an applicant for life insurance can make a decision in his own best interests; by reducing the opportunity for misrepresentation and incomplete comparison in replacement situations; and by precluding unfair methods of competition and unfair practices.

Section 3. Replacement of Life Insurance Defined.

The replacement of life insurance which, as used in this regulation, includes annuity and variable contracts, is defined as any transaction, not exempted in Section 4, below,

~~(A)~~(1) Wherein new life insurance is to be purchased and it is known to the agent or the agent has reason to believe that as part of the transaction, existing life insurance has been or is to be:

~~(2)~~ ~~Or it is known to the agent or the agent has reason to believe that, as part of the transaction, existing life insurance has been or is to be:~~

~~(1)~~ (a) Lapsed or surrendered;

~~(2)~~ (b) Converted into paid-up insurance, continued as extended term insurance, or under another form of nonforfeiture benefit;

~~(3)~~ (c) Converted otherwise so as to effect a reduction either in the amount of the existing life insurance or in the period of time the existing life insurance will continue in force;

~~(4)~~ (d) Reissued with a reduction in amount such that substantial cash values are released. ("Substantial cash values" include all transactions wherein an amount in excess of 50% of the tabular cash value is to be released on one or more of the existing policies.)~~,~~; or

~~(5)~~ (e) Assigned as collateral for a loan or subjected to substantial borrowing of the loan values whether in a single loan or under a schedule of borrowing over a period of time. "Substantial borrowings" include all transactions wherein an amount in excess of 50% of the tabular cash value is to be borrowed on one or more existing policies.

(2) Wherein a pending application is terminated and such application has been accompanied by an advance premium deposit for which a conditional advance premium receipt has been delivered to the applicant.

Section 4. Exemptions.

This regulation shall not apply when:

(1) The application for the new life insurance is made to the same insurer that issued the existing life insurance ~~and~~ when a contractual policy change or conversion privilege is being exercised;

(2) The new life insurance is provided under (i) a group term life insurance policy; (ii) a policy whose cost is borne in whole or in part by the insured's employer or by an association of which the insured is a member; a group policy covering debtors of a creditor sold in connection with a credit transaction; (iii) policies covering employees of an employer, debtors of a creditor, or members of an association, which are distributed on a mass merchandising basis and administered by group type methods; or (iv) life insurance policies issued in connection with a pension, profit sharing or other benefit plan qualifying for tax deductibility of premiums; provided, however, that as to any plan described in this subsection, full and complete disclosure of all material facts shall be given to the administrator of any plan to be replaced; no sales agency force is used by the insurer and all sales material is standard and printed and presented by direct mail or advertising, however, upon receipt of the application, such insurers shall mail to the insured as soon as the application is received, a copy of the Notice in Exhibit B with references therein to a written comparison statement deleted;

(3) The existing life insurance is a nonconvertible term policy with five years or less to expire and which cannot be renewed.

Section 5. Duties of Agent.

Each life insurance agent shall:

(1) Obtain with or as part of each application for life insurance a statement signed by the applicant as to whether or not such insurance will replace existing life insurance;

(2) Obtain a separate statement that the applicant does not intend to change, delete or modify any existing life insurance;

(3) Submit to the insurer in connection with each application for life insurance a statement as to whether or not he knows or has reason to believe replacement is involved in the transaction;

(4) Where a replacement is involved:

(a) Obtain with or as part of each application a list of all existing life insurance policies; ~~proposed to be replaced~~;

(b) Present to the applicant, not later than at the time of taking the application, a completed ~~"Comparison Statement"~~ "Disclosure Statement" signed by the agent and a "Notice to Applicants Regarding Replacement of Life Insurance" in form substantially as described in Exhibits A and B and leave such forms with the applicant for his records;

(c) Submit with the application to the insurer a copy of any proposal used and a completed ~~"Comparison Statement"~~ "Disclosure Statement" and the name of each insurer which issued any insurance being replaced;

(d) Have the applicant acknowledge receipt of the completed ~~"Comparison Statement"~~ "Disclosure Statement" and the "Notice to Applicants Regarding Replacement of Life Insurance.";

(e) Notify, within 48 hours of taking the application, the home office of the insurer whose insurance is being replaced, by registered or certified mail.

Section 6. Duties of Insurers.

Eash insurer shall:

(1) Inform its field representatives of the requirements of this regulation and supply its agents with copies of Exhibits A and B;

(2) Require with or as part of each application for life insurance a statement signed by the applicant as to whether such insurance will replace~~ment~~ existing life insurance;

(3) Require in connection with each application for life insurance a statement signed by the agent as to whether or not, ~~to the best of his knowledge,~~ he knows or has reason to believe replacement is involved in the transaction;

(4) Where a replacement is involved:

(a) Require with or as part of each application a list prepared by the agent representing, to the best of his knowledge, all of the existing life insurance policies; ~~proposed to be replaced;~~

(b) Obtain a copy of any proposal used, the completed ~~"Comparison Statement"~~ "Disclosure Statement," proof of the receipt by the applicant of the "Notice to Applicants Regarding Replacement of Life Insurance" and the name of each insurer whose insurance is being replaced;

(c) ~~Immediately~~ notify any insurer whose insurance is being replaced and ~~upon request promptly~~ furnish a copy of any proposal used and a completed ~~"Comparison Statement".~~ "Disclosure Statement" within four working days from the date of receipt of the application from the agent and at least 15 days prior to the issuance and delivery of the new contract;

(d) Examine any proposal used and the completed ~~"Comparison Statement"~~ "Disclosure Statement" ~~and~~ to ascertain that the latter meets the requirements of this regulation;

(e) Maintain copies of any proposal used and the completed ~~"Comparison Statement"~~ "Disclosure Statement," proof of receipt by the applicant of the "Notice to Applicants Regarding Replacement of Life Insurance" and the applicant's signed statement with respect to replacement in its home office for at least three years or until the conclusion of the next succeeding regular examination by the insurance department of its state of domicile, whichever is later.

(5) Assume responsibility for the accuracy of the information disclosed by its field representatives on any proposal and completed "Disclosure Statement."

Any insurer which receives notice that its existing insurance may be replaced shall maintain copies of such notification on its premises, indexed by insurer notifying it of such replacement, for three years or until the conclusion of the next regular examination conducted by the insurance department of its state of domicile, whichever is later.

Section 7. Options to Policyholders.

When an agent has failed to deliver a "Disclosure Statement" or where it is misleading or incomplete, the proposed insured has the right to request rescission of the new policy. Any costs relating to the rescission action by the issuing company are not to be borne by the applicant including a refund of any premiums paid. The original company shall reinstate the insured without proof of insurability.

Section ~~7~~ 8. Penalties.

(1) Any insurer, agent, representative, officer or employee of such insurer failing to comply with the requirements of this regulation shall be subject to such penalties as may be appropriate under the insurance laws of ________________.

(2) Policyholders have the right to replace existing life insurance after indicating in or as part of the applications for life insurance that such is not their intention; however, patterns of such action by policyholders of the same agent shall be deemed prima-facie evidence of the agent's knowledge that replacement was intended in connection with such transactions, and such patterns of action shall be deemed prima-facie evidence of the agent's intent to violate this regulation.

Section ~~8~~ 9. Exhibits.

(1) The forms set forth in the following Exhibits A and B are hereby approved for use as specified in this regulation. ~~Substantially equivalent forms may be adopted with the prior approval of the insurance ____________. To the extent that the forms in Exhibit A and B are not entirely appropriate for replacements involving annuity contracts, the company shall have the responsibility of adapting these forms to fit annuity cases when they arise.~~

Section ~~9~~ 10. Effective Date.

This regulation shall become effective on ________________.

Exhibit A
~~Comparison~~ Disclosure Statement

Name of Applicant____

Address____
Street City State Zip Code

Name of Insured if Other Than Applicant____________________________

Date of Birth of Insured____________________

~~I. COMPARATIVE INFORMATION~~

1. Item	+ Existing Life Insurance	Proposed Life Insurance
Policy Number		XXXXXXXXX
Insurance Company		
Amount of Basic Insurance:		
Currently	$	$
10 Years Hence	$	$
20 Years Hence	$	$
At Age 65	$	$
Basic Plan of Insurance		
Present Amount of Term Rider(s)	$	$
10 Years Hence	$	$
20 Years Hence	$	$
At Age 65	$	$
Accidental Death Benefit		
Family Income or Increased Protection Rider	$ ____ Monthly to Age ____	$ ____ Monthly to Age ____
Issue Age		
Issue Date		XXXXXXXXX

Premium for:	Premium	Yr. Premium Payable To	Year Coverage Ceases	Premium	Yr. Premium Payable To	Year Coverage Ceases
Basic Policy	$			$		
*Accidental Death Benefit						
*Waiver of Premium Benefit						
*Disability Income Benefit						
Family Income or Increased Protection Rider						
Option to Purchase Additional Insurance						
Other Benefits (Explain)						
Total Current Premium	$			$		
Frequency of Premium Payment						

* If Premium for Benefits: (A) Is not separable from basic policy premium, insert "Included in Basic Policy Premium," or (B) is an aggregate premium, show the aggregate premium.

\+ If more than one existing life insurance policy is to be affected by a transaction included within the definition of a replacement contained in Section 3 of the regulation, (1) the existing life insurance column of a separate signed ~~Comparison~~ Disclosure Statement form must be completed for each such policy providing the information required by the form with respect to existing policies, and (2) a separate signed ~~Comparison~~ Disclosure Statement form must be completed for the proposed policy. The latter form must summarize, to the extent possible, the information concerning the existing policies set forth on the separate forms, and must include the information required in Sections 2 through 5 of the ~~Comparison~~ Disclosure Statement.

Tabular Cash Values:	+ Existing Life Insurance	Proposed Life Insurance
At Present	$______	$______
1 Year Hence	______	______
5 Years Hence	______	______
10 Years Hence	______	______
At Age _____ (Highest Age Shown in Cash Value Table of Existing Policy)	$______	______
Cash Value of Any Existing Dividend Additions or Accumulations (If Available From Applicant)	$______	$______
Amount of Loan Now Outstanding, If Any	$______	$______
Rate of Loan Interest	______%	______%
Amount of Annual Loan Interest	$______	$______
Date Contestable Period Expires	______	______
Date Suicide Clause Expires	______	______
Dividends**		
Is Policy Participating?	______	______
Annual Dividend (Current Scale)		
1 Year Hence	______	______
2 Years Hence	______	______
5 Years Hence	______	______
10 Years Hence	______	______
Total 10 Years	$______	$______
Current Interest Rate on Dividends on Deposit	______	______

** Dividends are based on the 19___ dividend scale. The dividends shown are not to be construed as guarantees or estimates of dividends to be paid in the future. Dividends depend on mortality experience, investment earnings and other factors, and are determined each year in the sole discretion of the company's board of directors.

The agent is responsible for furnishing required dividend information. It is recommended that he obtain this for the policy being replaced from the company issuing the original insurance. As an alternative, however, he may show dividends on closest comparable policy, amount, age and duration from current statistical manuals (interpolating where necessary). It is to be recognized that dividend information under this alternative method, with respect to existing insurance is not likely to be as accurate as dividend information obtained directly from the company issuing the original insurance.

In order to calculate the cost of a cash value life insurance policy over a period of years it is necessary to consider the interest which could have been earned on premium monies if they had been invested rather than paid to the insurance company. It is not sufficient simply to compare the sum of net payments (total premiums minus dividends, if any) over a period of years with the cash value at the end of the period.

2. Advantages of Continuing the Existing Life Insurance:

(Provide Additional Space)

3. Advantages of the Proposed Replacement of the Existing Life Insurance:

4. Additional Information:

(A) The existing life insurance cannot fulfill your intended objectives for the following reason(s):

(B) Under the proposal, the existing life insurance policy will be tested as follows:

(C) Your existing life insurance policy (can) (cannot) be changed to provide the benefits desired under the proposed new insurance. If it can be so changed, the reason(s) for proposing new insurance rather than changing your existing policy is as follows:

5. The primary reason for the proposed replacement of the existing life insurance by new insurance is as follows:

________________	________________
Date	Signature of Agent
	________________
	Address

Source of dividend information used: ________________________________

____

I hereby acknowledge that I received the above ~~"Comparison Statement"~~ "Disclosure Statement" and the "Notice to Applicants Regarding Replacement of Life Insurance" before I signed the application for the proposed new insurance.

________________	________________
Date	Signature of Applicant

TO: J. Richard Barnes
Commissioner of Insurance
State of Colorado

FROM: Arthur P. Hartel, Jr.
Internal Revenue Service

DATE: June 2, 1977

RE: Federal Tax Treatment of Investment Annuities

You requested that I furnish you with a summary of the federal tax treatment of investment annuities and the current efforts being made to clarify the situation.

As you are aware, more than a dozen companies were engaged in issuing investment annuity contracts, more than forty states had approved the contract and tens of thousands of contracts were issued. The Industry Advisory Committee on Investment Annuities completed an initial draft of regulations which would have been ready for your consideration earlier in the year except for the intervention of Rev. Rul. 77-85. Because the Rev. Rul. 77-85 specifically overrode state insurance law, the committee has not finalized its recommendations.

For a period beginning in 1965 and ending with the issuance of Rev. Rul. 77-85 on March 9, 1977, investment annuities were taxed as a form of variable annuity. Rev. Rul. 77-85 generally preserved this treatment for contracts in existence on March 9, but changed the treatment for contracts entered into after that date.

Historically, investment annuities received the same tax treatment under Section 801(g) of the Internal Revenue Code (Code) and under Section 72 of the Code as other variable annuity contracts and more than seventy rulings were issued to companies and contractholders affirming such tax treatment. Section 801(g) of the Code defines, in pertinent part, a contract with reserves based on segregated asset account as one "which provides for the allocation of all or part of the amounts received under the contract to an account which pursuant to state law or regulation is segregated from the general asset accounts of the company."

However, Rev. Rul. 77-85 states: "The fact that under state law such individual does not formally have legal title to such assets, or that for certain state insurance law purposes such assets are treated as assets in a separate asset account of an insurance company, is not controlling for federal income tax purposes." (Page 6 of Rev. Rul.)

Thus, disregarding state insurance law, Rev. Rul. 77-85 states that the assets supporting the company's obligations under investment annuity contracts were owned by the contractholder rather than the insurer and concludes that no annuity contract has been entered into. The Rev. Rul. denies the investment annuity the same tax treatment as other variable annuities, thereby reversing its historical tax treatment. This resulted in the suspension of all sales of investment annuities.

After the matter was brought to the attention of a number of members of Congress, the United States Senate passed an amendment, on April 29, 1977, to the Revenue Act of 1977 which continued variable annuity tax treatment for all investment annuity contracts issued up to March 9, 1978. The purpose of the legislation was to give Congress time to consider the subject on its merits. The amendment was eliminated from the final bill by the joint Senate-House Conference Committee.

Other legislative efforts to restore the historical tax treatment are now being considered by members of both the House and the Senate.

FIAC filed suit on May 13 in the U.S. District Court for the District of Columbia against the Internal Revenue Service and the Treasury Department. The object of the suit is to reestablish the federal tax treatment of investment annuities that existed prior to Rev. Rul. 77-85.

FIAC has also asked for a preliminary injunction, which would permit new contracts to be sold, until the case is decided on the merits. The federal government must respond by June 8, and a hearing is set before U.S. District Judge C. R. Richey on June 17, 1977.

We anticipate that the federal administration will argue that the court does not have jurisdiction and therefore lacks the authority to rule in the case. As to the merits of the case, we expect they will argue in support of the ruling's proposition that state insurance law is not controlling, and then attempt to sustain the ruling's conclusions disregarding the treatment under state law. This approach of the federal administration was recently rejected by the Supreme Court in its April 26, 1977 decision in U.S. v. Consumers Life Insurance Company.

The federal administration may want to again test the question of whether the federal taxation of insurance companies is dependent upon federally conceived tax theories or upon the treatment accorded such companies under state insurance law. That the United States Congress intended that the treatment accorded under state insurance law shall have preeminence in determining questions of federal taxation is a proposition supported by the consumers' case.

The outcome of the lawsuit could turn on the question of whether state insurance law should be controlling as to the question of insurance reserves and public policy. Clearly the outcome of this litigation could profoundly affect the entire insurance industry if the Internal Revenue Service is permitted to substitute its judgements of transactions for those of the commissioners of the various states, particularly where the results reached are inconsistent with state law.

VARIABLE LIFE INSURANCE AND VARIABLE ANNUITIES (C4) SUBCOMMITTEE

Reference:
1976 Proc. Vol. II p. 639
1977 Proc. Vol. I p. 619

Hon. Maximilian Wallach, Chairman – District of Columbia
Hon. Jerry Buxton, Vice-Chairman – Missouri

AGENDA

No Agenda – Unscheduled Meeting

The Variable Life Insurance and Variable Annuities (C4) Subcommittee met at 1:30 p.m. in the Gold Room of the Radisson Hotel in Minneapolis, Minnesota on Wednesday, June 8. Since a quorum was not present, the actual meeting did not start until 1:45 p.m. when a quorum was present. The Superintendent of Insurance of Washington, D.C., Maximilian Wallach, chaired the meeting. The following states were represented: District of Columbia, Missouri, Connecticut, Minnesota, South Dakota and Indiana.

Status of Litigation

The commissioner from Connecticut stated that the litigation papers are still in the attorney general's office awaiting review.

Recommended Changes in Model Regulation

Mr. Paul Mason of the American Council of Life Insurance briefly pleaded for changes in the regulations; some of technical nature, some of substantive nature. He had no prepared written statement which he promises to furnish later.

Mr. Karl Davies from Equitable Variable Life Insurance Company pleaded that the lack of action by this subcommittee constitutes a handicap to his company because while 27 states have approved the sale of the Equitable product, other states point to the inactivity of the NAIC as a disinterest in this product. Therefore a number of states did not approve the sale of this product. The statement is attached to the report.

Questions and Answers

Only one basic question was asked; namely, whether or not it is indicated that the principles of variable life should be extended to variable endowment and other products, and if so, what changes in regulation are needed.

Report by the (C) Committee Technical Task Force to Review Valuation and Nonforfeiture Value Regulation

The task force report is attached. The summary of it is that no recommendations are possible at this time. Recommendations which will be made later will not interfere with the standing variable life regulations.

In executive session Mr. Richard Hemmings, NAIC Counsel, briefed the subcommittee in summary fashion on the various steps the subcommittee went through in the development of the regulations in question. In view of the fact that members seem to change quite often on this subcommittee, Mr. Hemmings offered to give a brief written summary to the members.

It was acknowledged by this subcommittee that three prior requests for changes were not acted upon. In fairness to the petitioners, a special meeting should be held to make certain corrections and determinations as to which other changes proposed should be made and whether or not additional changes are called for.

The meeting is to convene in Boston in connection with the NAIC Zone I meeting in September. It is planned that the meeting will not exceed one day. Details will be circulated with other material as soon as available.

The meeting adjourned at 2:30 p.m.

Hon. Maximilian Wallach, Chairman, District of Columbia; Hon. Jerry Buxton, Vice-Chairman, Missouri; Hon. William H. L. Woodyard III, Arkansas; Hon. Joseph C. Mike, Connecticut; Hon. Johnnie L. Caldwell, Georgia; Hon. Manuel A. Chaco, Guam; Hon. H. Pete Hudson, Indiana; Hon. Fletcher Bell, Kansas; Hon. Berton W. Heaton, Minnesota; Hon. Thomas A. Harnett, New York; Hon. Peter F. Mullaney, Rhode Island; Hon. Lowell L. Knutson, South Dakota.

Statement by Equitable Variable Life Insurance Company
on the NAIC Variable Life Insurance Regulation

June 8, 1977
Minneapolis, Minnesota

My name is Karl M. Davies. I am President of Equitable Variable Life Insurance Company (EVLICO). Our company, a wholly-owned subsidiary of the Equitable Life Assurance Society of the United States, is the only insurer in this country currently offering variable life insurance in the general market. I appriciate this opportunity to report to you on the fine progress our company is now making, and to urge the (C4) Subcommittee to turn its attention to the amendments to the model variable life insurance regulation which have been suggested.

My predecessor, Harry Walker, worked extensively with this subcommittee over a period of several years. He has fond recollections of these associations, even though they were a little rocky on a few occasions. I saw Harry just last weekend and he asked to be remembered to you.

I personally am looking forward to getting acquainted with the members of the (C4) Subcommittee and to working with you. I pledge my help and EVLICO's to facilitate in any way we can the sound launching of this promising new product.

We at EVLICO and at the Equitable are now convinced that VLI is real -- that it is a significant new addition to the insurance marketplace and that it is here to stay. Statements along these lines in the past may have contained an element of wishful thinking. We have now accumulated enough experience to believe there is real substance in such statements.

Sales of variable life insurance this year are most promising. During the last few weeks the weekly face amount applied for has been running close to $5 million. In annualized premium this amounts to about $70,000 per week. So far this year some $50 million of VLI has been paid for -- a figure to be compared with our first year, 1976, total production of $23 million. The $50 million represents $700,000 in annualized premium.

Our production goal for this year is $200 million in face amount. This amounts to about 10% of Equitable's sales of permanent life insurance in amounts of $25,000 or more -- a goal which is both realistic and challenging. It now appears that we will miss this target, not because of unsatisfactory sales but because of delays in securing state approvals. In the states where we can do business, our sales this year are averaging 106% of what is needed to attain our objective.

You might be interested in some characteristics of our sales. There is considerable variation in the popularity of VLI from state to state. In New York and California VLI sales come close to our target, but miss it slightly. Four important states which cleared VLI late last year or early this year, Florida, Illinois, Louisiana and New Jersey, have achieved production levels between one and one-half and two times our expectations.

We have been somewhat surprised to find that the age distribution of variable life sales has been much lower than expected. People in their 20's and 30's are buying VLI, and parents and grandparents are buying VLI on the lives of young children. This apparently reflects a perception by agents and the public that the anticipated favorable return on equity investments is more certain over the long pull. We welcome this reaction. At the same time we feel and will promote the concept that older individuals -- those in the 40's and 50's -- also have a long enough expectation of life to justify their purchase of variable life.

Clearly, VLI as presently designed is not the insurance product for an individual who needs coverage for a relatively short period, nor is it an investment product for the person who wants to play the stock market. Our marketing emphasis has been to encourage a balanced life insurance portfolio of both fixed and variable benefit policies. We surely have no illusions that ultimately VLI will take the place of fixed life insurance, but do feel that applicants should have the opportunity to choose variable or fixed, or a combination of both.

Another interesting development has been the fact that although our average policy is close to $35,000 (much larger than Equitable's), there has been a heavy concentration of sales at the minimum $25,000 amount level. On reflection, this too is a result to be expected as agents and clients seek to learn about a new product.

As to state approvals -- at the end of 1976 we were clear in 19 states; since that time we have received eight more approvals, for a total of 27 and two more states seem to be very, very close. About 65% of the Equitable agents who are qualified to sell equity products can now offer VLI to their clients.

Our greatest frustrations today arise in the area of receiving state approvals -- frustrations much more disheartening than any encountered in dealing with the SEC; and some of the states which are not acting on our submissions, with or without a regulation, use as their key explanation the fact that the NAIC has not clarified its position on a model regulation.

We also hear comments like, "Nobody is interested in VLI." My recitation above should disprove that statement.

With this background I wish to endorse and commend for your favorable action the amendments to the NAIC Model Variable Life Insurance Regulation which were proposed by the American Council of Life Insurance at the December, 1975 meeting of the (C4) Subcommittee. The proposed amendments would create a more streamlined and workable regulatory scheme. This, I might say, would be much on the order of the regulation promulgated by New York State a little more than a year ago. Harry Walker at the December 1975 subcommittee meeting pointed in particular to the fact that some of the amendments before the subcommittee "are designed to fill in gaps and to eliminate the more obvious, but nonetheless important, technical imperfections in the regulation. . . . Their present adoption would remedy technical flaws, broaden the discretionary powers of the commissioner in dealing with a foreign insurer, and generally smooth the operation of this important regulation."

I do not know whether any members of this subcommittee believe that the projected lawsuit against the SEC should preclude the adoption of the proposed modifications to the model regulation. I hope not. It strikes me that such a position would undermine the states' argument in the suit – it seems to demonstrate an unwillingness to regulate on the part of those who are suing for exclusive jurisdiction over VLI.

If the subcommittee feels that certain of the proposed changes would weaken the position of Connecticut in its lawsuit, then I recommend that the subcommittee nevertheless take action on the remaining amendments. For the NAIC to refuse to act at all – even with respect to obviously needed technical changes, for example – does not seem to be the best course.

I respectfully request this subcommittee, then, to consider and act upon the proposed amendments to the model variable life insurance regulation, and I surely recommend ACLI's suggestions.

(C) Committee Technical Task Force to Review Valuation and Nonforfeiture Value Regulation

Variable Life Insurance

June 1977

This report concerns only the proceedings of the NAIC Technical Task Force to Review Valuation and Nonforfeiture Value Regulation from the December 1976 meeting to the date of this report.

A. Proceedings

The advisory committee has been assigned the task of drafting revisions to model legislation and regulation required to accommodate the changes in legislation recommended for fixed benefit plans. The first report of the advisory committee is attached along with the minutes of the December 5, 1976 meeting and the March 31, 1977 meeting.

The advisory committee will continue to review the successive drafts of the revisions proposed for the standard nonforfeiture law. No recommendations for adoption by the NAIC will be made until the final form of the standard nonforfeiture law revisions has been determined.

B. Recommendations

No recommendations are possible at this time.

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(C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation

Phoenix, Arizona
December 5, 1976

The NAIC (C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation met from 9:00 a.m. until 6:00 p.m. on December 5, 1976 in the Board Room of the Hyatt Regency Hotel in Phoenix, Arizona.

Present were: For the NAIC technical task force, John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James R. Montgomery III, District of Columbia; Erma Edwards, Nevada; Thomas J. Kelly, New York; William R. Burns, North Dakota; J. Ramon Estefania, South Carolina; LaMar Walker, Utah; Bradford S. Gile, Wisconsin. Another state insurance department attending was Illinois, represented by Larry Gorski.

Representing the Society of Actuaries' Special Committee on Nonforfeiture Value Regulation were Ardian Gill, Chairman, Mutual of New York; Charles Greeley, Metropolitan Life Insurance Co.; Richard Miller, Southwestern Life Insurance Co. Representing the American Council of Life Insurance were Richard Minck and John K. Booth. Representing the Technical Advisory Committee on Variable Products was Jerome Golden of Equitable Variable Life Insurance Company, Chairman of that committee.

Other persons present at this meeting were David M. Holland, Munich American Resurance Co.; Carl R. Ohman, Equitable Life Assurance Society. For Milliman and Robertson, consulting actuarial firm were Howard Kayton and Gerald T. Coger. For Teachers Insurance and Annuity Association were J. Paul Quinn and Tom Walsh. For Anchor National Life Insurance Company were Greg Carney and Carroll Dietle.

A brief summary of the discussion follows, not in the order they occurred, but in order by NAIC subcommittee material.

(C4) Variable Products

1. The advisory committee has been assigned the task of drafting revisions to the model legislation and regulation required to accommodate the changes in legislation recommended for fixed benefit plans.

2. An investigation of asset value guarantees is needed.

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(C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation

San Francisco, California
March 30-31, 1977

The NAIC (C) Life, Accident and Health Insurance Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation met on March 30 and 31, 1977 at the office of the California Insurance Department in San Francisco, California.

Present at these meetings were: For the technical task force (all members attended both days), John O. Mongtomery, Chairman, California; W. Keith Sloan, Arkansas; Erma Edwards, Nevada; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah.

Members of the task force not in attendance were James Montgomery III, District of Columbia; William White, New Jersey; William R. Burns, North Dakota; Bradford S. Gile, Wisconsin.

Other state insurance department personnel attending were Richard W. Bean and Eugene E. Jacks from the California Department.

Representing the American Council of Life Insurance, Richard V. Minck (only for sessions involving life insurance) and John K. Booth (for all sessions). Representing the Health Insurance Association of America was Peter Thexton (March 31, 1977 meeting only). Representing the Society of Actuaries' Special Committee on Nonforfeiture Value Regulation were Charles Greeley and Harold B. Leff, Metropolitan Life, for all sessions; (Mr. Leff will represent Mr. Greeley at the June 1977 task force meeting.) Richard D. Miller, Southwestern Life (for all sessions); Alan Richards, Life Insurance Co. of California (March 30 meeting only). Representing the Society of Actuaries' Special Committee on the Construction of New Standard Ordinary Mortality Table was Wilbur Bolton, Occidental Life (March 30 meeting only).

Representing the NAIC Technical Advisory Committee on the Construction of Credit Disability Claim Cost Tables was Ken Jones, CUNA Mutual (March 31 meeting only). Representing the NAIC Technical Advisory Committee on the Valuation of Health Insurance Contracts was E. Paul Barnhart, Consultant (March 31 meeting only). Representing the NAIC Technical Advisory Committee on Valuation and Nonforfeiture Value Regulation for Variable Products was Thomas Walsh, Teachers Insurance and Annuity Association (March 31 meeting only).

Other persons attending were Robert A. Miller III, Aetna Life and Casualty (March 30 meeting only); Richard M. Stenson, Equitable Life Insurance Co. of New York (March 30 meeting only); Gregg Carney, Anchor National Life Insurance Co. (March 31 meeting only).

Change in NAIC Technical Task Force Membership

William R. Burns of the North Dakota Department has resigned from the NAIC technical task force and we will miss his many fine comments. I will continue to send Bill copies of the NAIC task force communications and if he is able we would appreciate any comments he might wish to make. Larry Gorski of the Illinois Department replaces Bill on the task force.

The membership of the technical task force now consists of John O. Montgomery, Chairman, California; W. Keith Sloan, Arkansas; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; William A. White, New Jersey; Thomas J. Kelly, New York; J. Ramon Estefania, South Carolina; Ted Becker, Texas; LaMar Walker, Utah; Bradford S. Gile, Wisconsin.

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Items for the (C4) Variable Life Insurance and Variable Annuities Subcommittee

Agenda Item 1. Model Legislation or Regulations.

(a) The Variable Products Technical Advisory Committee has submitted a report to the NAIC Technical Task Force on Valuation and Nonforfeiture Value Regulations (Attachment C).

(b) Coordination with regulation by other jurisdictions (Securities and Exchange Commission and other federal jurisdictions) is essential so as to not superimpose one layer of regulation on top of another.

(c) The NAIC technical task force does not include within its responsibilities the study of disclosure and loading regulation and should refer such matters to the appropriate NAIC committee.

(d) The NAIC technical task force and its technical advisory committee should make studies at this time and actual recommendations at the time the new standard mortality table has been prepared and revisions to the standard nonforfeiture law are proposed. The studies are suggested in the attached report.

(e) At this time it appears that a minimum nonforfeiture law is needed for individual deferred variable annuities parallel to that adopted by the NAIC in December 1976 for nonvariable individual deferred annuities.

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TO: (C) Technical Task Force to Review Valuation and Nonforfeiture Values

FROM: Thomas G. Walsh, F.S.A., Actuary
Teachers Insurance and Annuity Association of America
College Retirement Equities Fund
730 Third Avenue, New York, New York 10017

DATE: March 11, 1977

RE: Variable Products Technical Advisory Committee Interim Report

Attached is the interim report of the Variable Products Technical Advisory Committee chaired by Jerry Golden of the Equitable. Jerry is in the hospital undergoing knee surgery and has asked me to attend the meeting in San Francisco to answer your questions on this report and discuss the progress of this committee.

+

General Assignment

In August, 1976 our committee was formed to support the work of the NAIC (C) Committee Technical Task Force for Policy Reserves and Nonforfeiture Valuation. Our role was to consider and then draft changes in valuation and nonforfeiture value legislation and regulation for variable products corresponding to those adopted for fixed products. Our first meeting was held in January 1977 after the December NAIC meeting in Phoenix at which the proposals for the standard individual deferred annuity nonforfeiture law and revisions to the standard valuation and nonforfeiture laws were adopted.

Initially, we limited our investigation to:

1. The NAIC Model Variable Contract Law;

2. The NAIC Model Variable Annuity Regulation; and

3. The NAIC Model Variable Life Insurance Regulation.

We also considered other areas of law and regulations, as shown in Exhibit A attached, which might impact on our recommendations.

Scope of Study

The NAIC Model Variable Contract Law can be interpreted to permit the following types of products:

1. Individual and group variable life insurance.

2. Individual and group variable annuities.

3. Individual and group fixed dollar annuities.

4. Investment annuities.

We limited our current investigation to items 1 and 2 above. In view of the limited time we had to prepare a report, we felt we could not properly address item 3, and because of the developing nature of investment annuities (item 4) we suggest that a study of the valuation and nonforfeiture aspects of such products be deferred at this time. It is currently being studied by the Internal Revenue Service and another NAIC task force.

Approach

Our approach is to consider each change adopted at the December 1976 NAIC meeting and to determine whether similar changes should be made to the appropriate portions of the NAIC Model Variable Contract Law and corresponding regulations. We are also reviewing the model law and regulations to make sure that we did not overlook any areas needing changes.

In reviewing the above and other existing variable annuity regulations, we were not able to develop within the available time a nonforfeiture regulation for variable annuities. The items we considered and are trying to resolve are:

1. The coordination and compatibility of any NAIC regulation with the current regulations of the Securities and Exchange Commission.

2. The consistent treatment of fixed and variable accumulation within a combination contract.

3. Any minimum death benefit, maturity value and other asset value guarantees.

4. All special contractual provisions related to nonforfeiture provisions (e.g., policy loans, partial surrenders, deferment of surrender values, reinstatement, requirements for paid-up annuities).

5. The right of a company to cash out small paid-up policies.

6. The impact of valuation requirements on nonforfeiture values.

7. The appropriate levels of charges to recognize variable annuity costs.

8. The consideration of the greater need for adequate disclosure of variable annuity charges and the effect this would have on nonforfeiture regulation.

We also think that any proposed nonforfeiture regulation for variable annuities should be circulated to a larger group for comments before it is recommended to you. This is desirable because of the complexity of the product, and the extensive variable annuity regulation that currently exists. This step will reduce the possibility of a significant oversight and will make the eventual enactment of any regulations much smoother.

Existing Variable Annuity Regulation

Because of the extensive regulations already governing variable annuities relatively few complaints have been made concerning the level of variable annuity charges. These regulations include not only state laws but also federal securities laws and ERISA.

Variable annuities funded by separate accounts of which the assets are not derived solely from contributions under tax-qualified pension or profit sharing plans are regulated under the Investment Company Act of 1940. That act limits, among other things, the amount of sales load that can be charged and requires that management fees and fees for bookkeeping and certain other administrative services may not exceed such reasonable amounts as the SEC may prescribe.

Variable annuities issued to fund tax-qualified pension and profit sharing plans (as well as other employee benefit plans) are governed by ERISA. Under the fiduciary responsibility rules of that law, insurers issuing variable annuities to fund these plans are generally parties in interest as to the plans and may not receive aggregate compensation with respect to such annuities in excess of reasonable compensation within the meaning of ERISA.

Because of these regulations, there may not be a need for extensive state regulation of variable annuity premiums and charges. Certainly, there is no immediate need for such regulation and far less need to adopt nonforfeiture rules for variable annuities than for fixed annuities, which, are solely regulated by state laws.

Additional Disclosure Should be Permitted

Based on our study, we believe that regulatory concerns about variable annuities would be reduced if insurers were permitted to use hypothetical illustrations of premiums and benefits (based on assumed rates of return) in marketing variable annuities. Use of such illustrations would facilitate comparisons of different variable annuities and would make insurers more sensitive to competitive pressures in determining premiums and charges.

Although the NAIC model variable annuity regulation permits such illustrations, the SEC has, in effect, prohibited such illustrations. Among other things, the SEC will not permit an illustration based on the annuitant's age and sex and the amount of premium payments but will only permit an illustration for an annuity for a 45 year old man providing for premium payments of $50 per month. The SEC also requires disclosure of effective rates of return on the annuity and "group effective returns," which we believe are misleading.

We recommend that the NAIC direct this committee to develop appropriate illustrations of variable annuities based on assumed rates of return. We also recommend that after such illustrations are developed that the SEC be urged to permit the use of such illustrations in the sale of variable annuities. As with the detailed disclosure now required in a prospectus for variable life insurance, prospective purchasers of variable annuities should know the combined effect of charges and other factors relating to such annuities.

Model Variable Life Insurance Regulation

The revisions adopted at the December, 1976 NAIC meeting removed the linkage between the standard valuation law and standard nonforfeiture law. Thus, for annual premium fixed dollar life insurance there is a maximum valuation interest rate of 4½% and a maximum interest assumption for policy nonforfeiture value calculations of 5½%, while for single premium life insurance the rates are 5½% and 6½%, respectively. These revisions were made in advance of the adoption of major changes to the standard nonforfieture law for life insurance your task force is currently studying.

Unlike fixed life insurance, the valuation interest rate, the rate used to determine nonforfeiture values and the assumed investment rate used in determining benefits under a variable life insurance policy are not clearly separable. The calculation of both the variable benefits and the nonforfeiture values may be related to all three of those interest rates. The model VLI regulation also contains provisions which (1) require an increase in cash values if premiums exceed a certain level (as determined by a formula specified in the regulation) and (2) limit the asset charges an insurer may impose. The ACLI has recommended to the (C4) Subcommittee, among other things, that these provisions be eliminated from the model regulation. Finally, research on valuation and other questions relating to minimum death benefit and minimum asset value guarantees has only scratched the surface.

Because of the complexities of the VLI regulation suggested above, we are recommending that changes to the NAIC model VLI regulation in the nonforfeiture and valuation area be deferred until the NAIC acts on (a) the changes to the standard nonforfeiture law for life insurance and (b) the ACLI recommended changes to the model VLI regulation. During this interim model VLI regulation should be studied as follows:

1. The impact of an increase in the assumed interest rate on (a) the potential for increases in benefits above any guaranteed minimums and (b) the risks assumed by the insurer;

2. The modifications to the regulation which would permit an insurer to use a nonparticipating basis of determining changes in variable benefits; and

3. The development of appropriate regulations for a VLI policy with significant cash value guarantees and with the separate account having an investment policy similar to the insurer's general account.

EXHIBIT A

Other Laws or Regulations Impacting on Committee's Study

1. Standard Nonforfeiture Law for Life Insurance.

2. New York Regulation 47 on Variable Annuities.

3. California Regulation on Investment Annuities.

4. California Regulation on Asset Value Guarantees.

5. NAIC Model Cost Disclosure Regulation.

6. SEC Rule 6e-2.