

## ATTACHMENT D

To: John O. Montgomery, Chief Actuary  
California Insurance Department

From: Vincent W. Donnelly, Associate Actuary  
American Council of Life Insurance  
1850 K Street, N.W.  
Washington, D. C. 20006

Date: May 11, 1978

Re: Credit Insurance Rate Deviation

As you will recall, the NAIC, during its December meeting, agreed to take under review the credit insurance rate deviation (i.e. case rating) standards now incorporated in the NAIC model law. This project was assigned to your technical task force (actually we were told that you had previously been assigned this project). The minutes of the March 13 meeting of the technical advisory committee, which you received during your April 6 meeting in Tampa, indicate that the advisory committee has incorporated this project into its charge.

Because of the importance of this project to the American Council of Life Insurance, we have appointed an ad hoc task force which, hopefully, can work with both your technical task force and the technical advisory committee in the resolution of the problems currently being experienced with the rate deviation standards.

Members of this ad hoc task force are: Harold E. Ruck, Chairman, Volunteer State Life; James F. Blazek, Alexander Hamilton Life; Kenneth D. Jones, CUNA Mutual; James T. McNamara, Prudential; Gareth W. Tolman, American National. Staff Contact: Vincent W. Donnelly, ACLI.

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 LIFE INSURANCE (C3) SUBCOMMITTEE

## Reference:

1977 Proc. Vol. II p. 494  
1978 Proc. Vol. I p. 472

Hon. Maximilian Wallach, Chairman -- District of Columbia  
Hon. John G. Day, Vice-Chairman -- Virginia

## AGENDA

1. Report of the Technical Task Force on Standard Nonforfeiture and Reserve Valuation Laws.
2. Report of Cost Disclosure of Life Insurance Task Force.
3. FTC's suggestion of its life insurance cost comparison plan.
4. Discussion of recommendation made by the Governmental Liaison (EX5) Subcommittee to this subcommittee to developing a mechanism for monitoring the impact of the NAIC Life Insurance Solicitation Regulation.
5. Report of Replacement Task Force.
6. Report of Task Force on Federal Tax Treatment of Investment Annuity Contracts.
7. Report of the Task Force on Revision of Model Bill Defining Group Life Insurance and Development of a Model Bill defining group health insurance.
8. Status of lawsuit against the SEC concerning variable life insurance and annuity regulation.
9. Any other matters brought before the subcommittee.

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The meeting of the Life Insurance (C3) Subcommittee was called to order on June 12, 1978 in the International Center of the Washington Hilton Hotel, Washington, D. C. at approximately 3:50 p.m. With business still to be covered, the subcommittee adjourned at 5:45 p.m. and reconvened on Wednesday in the same room, at approximately 2:30 p.m. Chairman Wallach presided, and a quorum was present consisting of the following or their representatives: District of Columbia, Colorado; Maryland; Nevada; Puerto Rico; Tennessee; Texas; Virginia. The following business was addressed.

James R. Montgomery III gave the report of the Technical Task Force on Standard Nonforfeiture and Reserve Valuation Laws as the Chairman of that task force was unable to attend (report attached). The Special Report of that task force, dated May 1978, contains four guidelines which were received and adopted by the subcommittee with a recommendation that they be referred to the Financial Condition Examination (A5) Subcommittee to be considered for inclusion in the Financial Condition Examiners Handbook.

The report of the Cost Disclosure of Life Insurance Task Force was given by Erma Edwards. It was received and adopted. This report, attached, includes an adopted Model Annuity Disclosure Regulation.

Michael Lynch, a staff economist for the FTC, gave a report of the activities of the FTC in regard to suggestions for life insurance cost disclosure plans. No action was necessary on this item, and none was taken by this subcommittee.

A discussion of recommendations made by the Governmental Liaison (EX5) Subcommittee to this subcommittee to develop a mechanism for monitoring the impact of the NAIC Life Insurance Solicitation Regulation was included in the report by Erma Edwards earlier in the agenda and is included in that report's adopted recommendations.

Considerable and rather lengthy discussion took place on the report of the Replacement Task Force which, when given, showed disagreement among industry despite the fact that the task force was assisted by an industry advisory committee. The proposed regulation, which is attached was received and accepted as an exposure draft. The American Council of Life Insurance opposed certain provisions (see their statement which is attached). Individual companies also made statements which were made available for distribution. Those are not attached here.

Commissioner Barnes, Colorado, called on W. Thomas Kelly, President of the Investment Annuity Institute, Inc., who gave a brief report of the effects of changes in federal tax laws currently pending in Congress regarding the tax treatment of investment annuity contracts following a recent adverse court decision. No action was necessary by this subcommittee.

The report of a task force to study revision of the NAIC model bill defining group life insurance and the development of a model bill defining group health insurance was given. An exposure draft (attached) was prepared for the first part of the topic (group life) in order to deal with the entire topic in two parts. A report from the industry advisory committee as given by its Chairman, William Hannan, is also attached.

Superintendent Wallach reported that it does not seem likely that Connecticut will initiate court action against the SEC concerning variable life insurance, but the possibility exists that another state might.

No other matters came before the subcommittee. There being no further business, the meeting adjourned at approximately 3:00 p.m. on the second day of the meeting.

Hon. Maximilian Wallach, Chairman, District of Columbia; Hon. John G. Day, Vice-Chairman, Virginia; Hon. J. Richard Barnes, Colorado; Hon. Manuel A. Chaco, Guam; Hon. Sherman A. Bernard, Louisiana; Hon. Edward J. Birrane Jr., Maryland; Hon. James L. Wadhams, Nevada; Hon. Rolando Cruz, Puerto Rico; Hon. Peter F. Mullaney, Rhode Island; Hon. Millard Oakley, Rhode Island; Hon. Durwood Manfred, Texas.

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Life Insurance Cost Disclosure (C3) Task Force

Washington, D. C.

June 10, 1978

The Life Insurance (C3) Cost Disclosure Task Force met on May 1, 1978 at the Hilton Hotel, in Biloxi, Mississippi. This task force is presently working with advisory committees on three projects: a study of life insurance policy lapsation, a study of dividend practices and the development of an annuity disclosure regulation.

A progress report on the study of policy lapsation was given by Helen Noniewicz, LIMRA, Chairman of the advisory committee, the gist of which is as follows:

The charge to this advisory committee was twofold.

A. To conduct a study of lapsation taking into consideration the questions posed by the original life policy lapsation task force.

1. Is there a lapse problem?
2. How extensive is the lapse problem?
3. What are the factors affecting persistence?
4. What effect do lapses have on rates for all other insureds?
5. What is the extent of injury to consumers where a high lapse rate exists?
6. What possible solutions may we find?

B. The development of a lapse rate disclosure system to enable regulators to identify companies which have excessive cash value plan lapse rates and provide a basis for them to require the companies involved to take measures to either improve their persistency or justify the high lapse rates.

The written advisory committee report on the present status of these projects is attached.

A report on the current activities of the Society of Actuaries Committee on Dividend Philosophy was submitted by Chairman J. Edwin Matz. He reported that the committee has developed a tentative Actuarial Opinion dealing with dividend practices of mutual companies. The Opinion will be presented to the appropriate officials of the Society of Actuaries and the American Academy of Actuaries at their meeting on June 7. In addition to the Opinion, the committee has drafted a proposed actuarial statement which will be recommended to the NAIC for possible inclusion in Schedule M of the annual statement. This proposal will require that the appropriate actuary, familiar with a particular company's dividend scales and formulas, state his opinion as to the compliance (or noncompliance) of those scales and formulas with the appropriate Actuarial Opinion adopted by the Academy of Actuaries. Mr. Matz's report is attached.

The task force reviewed suggested amendments to the proposed model annuity disclosure regulation. An exposure draft of this regulation was circulated at the December meeting.

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A second meeting of the task force was held on June 10, 1978 at the Washington Hilton Hotel. Suggested amendments to the exposure draft were reviewed. Some editorial changes were made to the original draft to clarify the intent of the provisions. There were no changes in the general direction or purpose of the regulation. The corrected copy of the regulation was made available at the distribution center June 10. We would like to recommend the adoption of the Model Annuity and Deposit Fund Disclosure Regulation by the NAIC.

The task force noted the recommendation made by the Governmental Liaison (EX5) Subcommittee to the (C3) Subcommittee and this task force to develop a mechanism for monitoring the impact of the NAIC Life Insurance Solicitation Regulation. The task force feels this could best be accomplished by appointing an advisory committee to undertake a study of the effectiveness of the regulation and recommend guidelines for monitoring its utilization by the consumer. The task force noted that the regulation has been in force in the various states for only a short period of time, and any credible experience regarding its impact on consumers is not yet available.

Task force members in attendance at the Sunday meeting included: Hon. Berry Balka, Nebraska; James Montgomery, District of Columbia; Frank Howatt, Oregon; Erma Edwards, Nevada. Iowa was not represented. Also in attendance were: Tom Kelly, New York; Richard A. Hemmings, Central Office.

Erma Edwards, Chairman, Nevada; James Montgomery III, District of Columbia; Bill Homan, Iowa; Hon. M. Berri Balka, Nebraska; Frank Howatt, Oregon.

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Life Insurance (Policy Lapsation (C3) Advisory Committee

March 28, 1978

The Industry Advisory Committee to Study Life Insurance Policy Lapsation has held two meetings, January 31, 1978 and March 28, 1978.

The task force charge to this committee is twofold.

A. To conduct a study of lapsation taking into consideration the following questions posed by the original life policy lapsation task force:

1. Is there a lapse problem?
2. How extensive is the lapse problem?
3. What are the factors affecting persistency?
4. What effect do lapses have on rates for all other insureds?
5. What is the extent of injury to consumers where a higher lapse rate exists?
6. What possible solutions may we find?

B. The development of a lapse rate disclosure system to enable regulators to identify companies which have excessive cash value plan lapse rates and provide a basis for them to require the companies involved to take measures to either improve their persistency or justify the high lapse rates.

To provide answers to the original questions and complete the first part of the charge, the committee has the following assignments under way.

1. Is there a lapse problem?

The approach to be used to answer this question is to describe the concerns of the various groups of interest parties (NAIC, insurance industry, FTC, U. S. Senator Hart Hearings (73/74), individual critics and individual policyholders) to ascertain to what extent these groups have shown concern or believe that this is a problem; to determine what the problem is thought to be; and what evidence is cited as a cause of their concern.

2. How extensive is the lapse problem?

An equitable disclosure system will demonstrate the extent of the lapse problem.

3. What are the factors affecting persistency?

An extensive literature search revealed numerous groups of factors affecting persistency. A breakdown of these groups is attached to the report.

4. What effect do lapses have on rates for all other insureds?

A preliminary descriptive paper on the initial effect that lapses have on other policyholders, that is, the negative effect on others that occurs if there is lapsation during the early life of the policy has been completed. In addition, secondary effects are described in the paper taking into consideration overhead, administration expenses, affect on mortality costs, affect on investment results, etc. The committee is also currently working on a project to demonstrate how persistency affects the cost of insurance to the consumer. This is being done by varying lapse rate assumptions in an asset share program and producing an entire scale of dividends for a particular plan and issue age.

5. What is the extent of injury to consumers where a high lapse rate exists?

This question is not currently under consideration.

6. What possible solutions may we find?

The committee has developed an extensive listing of individual company strategies to encourage persistency. A copy of the list is attached to this report.

The second part of the charge is to develop the lapse disclosure system. In developing such a disclosure system, the committee must decide what data the industry should supply. To avoid unfairness and misrepresentation, there must be some normalization of data due to the inherent differences in persistency found in the various markets in which companies operate. The committee is currently reviewing two possible systems - one that would study persistency for five different durations, separately for cash value plan versus term insurance. Normalization for market differences would be based on mode of premium payment and age of insured. An alternate approach being investigated is to find expected lapse rates based on various pieces of information (i.e. size of company, average size policy, termination figures, etc.) already being reported in the annual statement. These expected lapse rates would be compared to the companies' actual rates.

The next meeting is scheduled for July 14, 1978 at LIMRA.

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### Factors Affecting Persistency of Ordinary Business

Persistency studies have consistently shown that income and mode of premium payment are the major factors related to persistency, i.e. persistency improves as income increases and improves with less frequent premium payments. Other factors which have some relationship with persistency when corrected for their relationship with mode and income are as follows.

#### Buyer Related

Higher than average persistency is found among buyers who are:

1. At older ages.
2. Professionals, executives and proprietors.
3. Already owners of life insurance in the same company.
4. Insuring the lives of juveniles or students.
5. Initiating the sale themselves.
6. Females.
7. Previous nonlapses.

#### Product Related

Higher than average persistency is found among policies that are:

1. Permanent rather than term.
2. Higher in premium.
3. Without policy loans.
4. Underwritten on a medical basis.
5. Sold with an insurability option rider.
6. Larger policies issued on a preferred risk basis.
7. Business policies rather than personal policies.
8. Issues as applied for.
9. Are sold with a waiver of premium provision in the combination agent market.

Individual pension trust policies enjoy higher persistency during the first policy year and lower than average persistency in subsequent years. Similarly, high early cash value plans and modified life plans have superior persistency in the early policy years with a substantial drop in subsequent years.

#### Agent Related

1. Persistency increases as the agent's length of service increases.
2. Among newer agents, subsequent terminators sell business with poor persistency.
3. Persistency is positively related to level of agent's product knowledge.
4. The poor persistency of orphan business is attributable to poor agents selling poor business; the loss of contact seems less crucial.

#### Sales Process Related

Higher lapsation occurs when:

1. There is only a partial premium or no cash with application.
2. Savings and thrift are stressed by agent.
3. Policies are not delivered personally to insured.
4. Post-sale service is not employed.

#### Related to the Outside Environment

1. The Economy. Persistency tends to (a) be poor during periods of unemployment and high interest rates; (b) improve when personal savings and effective buying incomes are high.
2. The Competition. Growing competition offered by competitive investment media increases replacements.
3. The Geographic Areas. Generally, persistency appears to be better in the northern part of the United States.

Unrelated Factors

A number of factors which were studied showed no practical relationship to persistency. These are:

1. Urban vs. rural characteristics of agency.
2. Marital status (with the exception that married men are more persistent for the monthly modes).
3. Settlement options.
4. Size of policy [Note: The belief existed that the larger the policy, the more likely it was to persist. Yet, past research shows that there is no difference in the persistency by size of policies within income groups. Naturally, there is a relationship between income and size of policy and, since policyholders with higher incomes tend to persist better than those with lower incomes, a study which combines policies from all income levels shows a spurious relationship between persistency and the size of policy.]

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Report on Alternative Methods of Solving the Lapse ProblemA. Individual Company Approach

The following approaches have been used or could be used by an individual company in attacking its lapse problem.

## 1. Compensation of Field Personnel

Obviously, deferred first year commissions and renewal commissions are not paid beyond the date of last premium payment, but this is not what we are referring to. There is a wide range of things that can be done by a company in this area. Increased incentives, of a modest nature, can be paid for good persistency. Alternatively, negative elements of compensation can be introduced for poor persistency. Such negative elements of compensation can be relatively minor or they can be so substantial that they involve a cancellation of substantial portions of first year commissions as regards policies that lapse before a certain period.

Such compensation items can be introduced for agents, first-line supervisors, agency managers and even for personnel with the responsibility of supervising several agencies.

## 2. Security Benefits

At least one company eliminates noncontributory group insurance for agents whose first year persistency falls below a certain level (75%). ERISA does not permit such a practice for pension benefits.

## 3. Agent's Honor Clubs

Here again, there is a wide variety of possible levels of action.

- a. Outstanding persistency can be converted to extra formula credit to assist agents with good persistency in qualifying for the club.
- b. Agents below a certain first year persistency level (such as 90%) can be absolutely barred from attending the club.
- c. Agents with outstanding persistency can receive special awards at the club, and these awards can be virtually on a par with awards for the top-producing agents or they can be somewhat less impressive than those awards.
- d. As with compensation, special honor club recognition of persistency can, and probably should, take place at all levels of field forces agent, first-line supervisor, agency manager and superintendent of agencies.

## 4. Agent Training and Supervision

Many companies give great emphasis in their programs of training and supervising agents to all aspects of improving persistency. Such companies generally encourage their agents to sell so-called quality business - to sell new business in such an effective fashion that it stays sold and to take all necessary steps to conserve business where problems do arise.

5. **Special Underwriting**

Some companies have special lists of agents with poor persistency and maintain more rigid underwriting standards relative to the new applications of such agents.

6. **Termination of Agents**

Some companies actually go so far as to terminate agents whose persistency is unsatisfactory. Agency training allowance plan (STEP) will automatically fail an agent who cannot maintain a 75% first year persistency rate.

7. **"Jawboning"**

Speeches and continued emphasis from key company people -- from the president on down -- about the importance of reducing lapse rates and the like is a tactic used by many companies. One company is highly committed to improving persistency. Its full program follows below.

**B. Industry Approach**

1. At least some of the above listed approaches for individual companies could probably be adopted into an industry approach under the supervision of local state Insurance Departments or what-have-you.
2. In addition to these kinds of approaches, it is obviously possible for a state Insurance Department to selectively work with those companies in their state which have the very poorest lapse rates. In fact, the selective work with those companies could very well lead to the introduction by these companies of some of the steps listed above.

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**The "Committed Company" Program**

**1. Philosophy and Goal**

The company's philosophy has long been one of stressing the importance of quality business. It has geared agent training, supervision, compensation and recognition, and just recently, agency manager compensation to the achievement of low lapse rates. The company's immediate goal is to reduce its mean lapse rate to 12% from 15.7% in 1976 and 13.6% in 1977.

**2. Training**

- a. The new Career Builder, that is, full time agents in their first three calendar years plus their year of hire, must pursue a career development program which includes the study of a Quest for Quality program.
- b. The Quest for Quality program describes what is meant by quality business and covers quality prospecting, methods of selling and servicing clients and requires the submission of a persistency rating chart with each application.

**3. Persistency Rating Chart**

- a. This form was developed with LIMRA's assistance, based on our own company's experience.
- b. On a scale rated two to nine, any case submitted with a rating of six or below must be explained by the agent and endorsed by the agency manager or supervisor.
- c. Each month a computer-printed sheet listing each Career Builder's cases with scores for each weighted factor and the case rating is sent to the agency manager for his use in supervising and controlling the type of business being sold by each agent.

**4. Lapse Bulletins**

- a. Each month, computer-prepared Lapse Bulletins for every agent and for the agency as a whole are sent to each agency. These bulletins track first-year lapses on a block of business paid for during a previous 12-month period running from October 1 through September 30.
- b. Lapses are calculated by number and amount with percentages combined into a mean.

5. Production Club Qualification

- a. Club qualifiers must have a lapse rate by number or amount of no more than 15% if they are beyond their third year in the business.
- b. Career Builders are permitted to qualify on the basis of the more favorable of their lapse bulletin, if 25% or less, or a year-end Persistency Rating Score of seven or better in their first two years and 7.5 in their third year.

6. Conservation Award

- a. Production Club members may qualify for a Conservation Award if they have a mean lapse rate of 10% or less with the amount of the award being graded downward from 5% of the commissions to 1% as their lapse rate increases from zero to 10%.
- b. Agency heads who qualify for their Production Club may qualify for a Conservation Award if their Career Builder lapse rate is 15% or less.

7. Agency Manager Compensation

One factor in our Agency Manager Compensation formula rewards the manager for each case persisting above a company standard and penalizes him for each lapse in excess of the company standard. The company standard is declared each year in advance.

8. Reassignment of Reinstated Policy

If an agent is successful in reinstating a lapsed policy of an orphan policyholder, he is entitled to the continuing commissions on that policy.

9. Danger Notices, Late Payment Offers and Reinstatement Offers

The company utilizes the above devices to conserve policies.

10. Additional Recognitions for the Sale of Quality Business

- a. National Quality Award. This award is promoted and recognition is given to winners.
- b. Agents having 100% persistency are listed in convention publications.
- c. Field organ is used to promote quality and to publish articles by field associates.

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To: Erma Edwards  
Nevada Division of Insurance

From: J. Edwin Matz, President and Chief Operations Officer  
John Hancock Mutual Life Insurance Company  
Boston, Massachusetts

Date: April 27, 1978

Re: Committee on Dividend Philosophy

This letter will bring you up to date on the activities and intentions of the Committee on Dividend Philosophy since we issued our Interim Report to the Society of Actuaries last October.

You will recall that the Society of Actuaries and the Academy of Actuaries have adopted some formal Guides to Professional Conduct for the guidance of their membership. The Guides are further amplified as to their applicability to individual functions of actuaries by formally adopted Opinions.

You will also recall that our committee's Interim Report indicated that we expected to formulate Opinions relating to dividend practices for individual insurance. We have continued to pursue this course, and we are now close to the completion of an Opinion which deals with dividend practice of mutual companies. We have invited appropriate officials of the Society of Actuaries and the American Academy of Actuaries to attend the committee's next meeting (which will be held June 7) in order to plan for formal adoption of this Opinion by those two bodies. Beyond that, we have already begun work on supporting Recommendations, to amplify the Opinion in greater detail, which might be adopted by the Academy at some time in the future.

In addition to this Opinion, the committee has drafted a proposed statement of actuarial opinion which we expect to recommend to the NAIC for possible inclusion in Schedule M. This proposal would require that the appropriate actuary, familiar with a particular company's dividend scales and formulas, state his opinion as to the compliance (or noncompliance) of those scales and formulas with the above-mentioned Opinion. It is our hope to bring this recommendation before the NAIC through the appropriate channels when action on the Opinion itself has been completed.

The committee still has a number of other matters on its agenda, including the matter of participating insurance issued by stock companies. However, we are not now at a stage where there would be any value in reporting on these matters. We do expect to maintain continuing contact with your subcommittee to bring our conclusions and recommendations before you as they emerge.

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**NAIC Model Annuity and Deposit Fund Disclosure Regulation**  
(As Adopted by the NAIC, June 16, 1978)

**Section 1. Authority**

This rule is adopted and promulgated by (title of supervisory authority) pursuant to sections (insert sections corresponding to Section 4(1)(a) of the Model Unfair and Deceptive Acts and Practices in the Business of Insurance Act) of the Insurance Code.

**Section 2. Purpose**

- A. The purpose of this regulation is to require insurers to deliver to prospects for annuity contracts, or for deposit funds accepted in conjunction with life insurance policies or annuity contracts, information which helps the prospect select an annuity or deposit fund, or both, appropriate to the prospect's needs, improves the prospect's understanding of the basic features of the plan under consideration and improves the prospect's ability to evaluate the relative benefits of similar plans.
- B. This regulation does not prohibit the use of additional material which is not in violation of this regulation or any other (state) statute or regulation.

**Section 3. Scope**

- A. To the extent hereinafter provided, this regulation shall apply to any solicitation, negotiation or procurement of annuity contracts, or deposit funds accepted in conjunction with individual life insurance policies or with annuity contracts which are subject to this regulation, occurring within this state. The regulation shall apply to any issuer of life insurance policies or annuity contracts, including fraternal benefit societies.
- B. This regulation shall apply to:
  - 1. Individual deferred annuities other than: (a) variable annuities; (b) investment annuities; and (c) contracts registered with the federal Securities and Exchange Commission.
  - 2. Deposit funds (i.e. arrangements under which amounts to accumulate at interest are paid in addition to life insurance premiums or annuity considerations under provisions of individual life insurance policies or annuity contracts).

C. This regulation shall not apply to:

1. Group annuity contracts whose cost is borne in whole or in part by the annuitant's employer or by an association of which the annuitant is a member. The cost of a contract shall not be deemed to be borne by an annuitant's employer to the extent the annuitant's salary is reduced or the annuitant foregoes a salary increase.
2. Immediate annuity contracts.
3. Policies or contracts issued in connection with employee benefit plans as defined by section 3(3) of the federal Employee Retirement Income Security Act of 1974 (ERISA) as amended from time to time.
4. Individual retirement accounts and individual retirement annuities as described in section 408 of the federal Internal Revenue Code.
5. A single advance payment of specific premiums equal to the discounted value of such premiums.
6. A policyholder's deposit account established primarily to facilitate payment of regular premiums and where the anticipated balance of such account does not exceed twice the sum of the premiums payable in one year on all policies for which premiums are being paid from such account.

Section 4. Contract Summary

- A. The purposes of this regulation, "Contract Summary" means a written statement describing the elements of the annuity contract and deposit fund, including but not limited to:
1. A prominently placed title as follows: "Statement of Benefit Information." (This shall be followed by an identification of the annuity contract or deposit fund, or both, to which the statement applies.)
  2. The name and address of the insurance agent or, if no agent is involved, a statement of the procedure to be followed in order to receive responses to inquiries regarding the Contract Summary.
  3. The full name and home office or administrative office address of the insurer which will issue the annuity contract or administer the deposit fund.
  4. The death benefits for the deposit fund, and for the annuity contract during the deferred period, and the form of the annuity payout. In the case where a choice of annuity payout form is provided, this item shall show the payout options guaranteed and the form of annuity payout selected for items 6, 7 and 9 of this section.
  5. A prominent statement that the contract does not provide cash surrender values if such is the case.
  6. The amount of the guaranteed annuity payments at the scheduled commencement of the annuity, based on the assumption that all scheduled considerations are paid and there are no prior withdrawals from or partial surrender of the contract and no indebtedness to the insurer on the contract.
  7. On the same basis as for item 6 except for guarantees, illustrative annuity payments not greater in amount than those based on (1) the current dividend scale and the interest rate currently used to accumulate dividends under such contracts, or the current excess interest rate credited by the insurer, and (2) current annuity purchase rates. A dividend scale or excess interest rate which has been publicly declared by the insurer with an effective date not more than two months subsequent to the date of declaration shall be considered a current dividend scale or current excess interest rate.

8. For annuity contracts or deposit funds for which guaranteed cash surrender values at any duration are less than the total considerations paid, a prominent statement that such contract or fund may result in loss if kept for only a few years, together with a reference to the schedule of guaranteed cash surrender values required by item 9c of this section.
  9. The following amounts, where applicable, for the first five contract years and representative contract years thereafter sufficient to clearly illustrate the patterns of considerations and benefits, including but not limited to, the tenth and twentieth contract years and at least one age from 60-65 or the scheduled commencement of annuity payments, if any, whichever is earlier:
    - a. The gross annual or single consideration for the annuity contract.
    - b. Scheduled annual or single deposit for the deposit fund, if any.
    - c. The total guaranteed cash surrender value at the end of the year or, if no guaranteed cash surrender values are provided, the total guaranteed paid-up annuity at the end of the year. Values for a deposit fund must be shown separately from those for a basic contract.
    - d. The total illustrative cash value or paid-up annuity at the end of the year, not greater in amount than that based on (1) the current dividend scale and the interest rate currently used to accumulate dividends under such contracts or the current excess interest rate credited by the insurer, and (2) current annuity purchase rates. A dividend scale or excess interest rate which has been publicly declared by the insurer with an effective date not more than two months subsequent to the date of declaration shall be considered a current dividend scale or current excess interest rate.
  10. For a Contract Summary which includes values based on the current dividend scale or the current dividend accumulation or excess interest rate, a statement that such values are illustrations and are not guaranteed.
  11. The date on which the Contract Summary is prepared.
- B. The Contract Summary must be a separate document. All information required to be disclosed must be set out in such a manner as not to minimize or render any portion thereof obscure. Any amounts which remain level for two or more contract years may be represented by a single number if it is clearly indicated what amounts are applicable for each contract year. Amounts in items 4, 6, 7 and 9 of this section shall, in the case of flexible premium annuity contracts, be determined either according to an anticipated pattern of consideration payments or on the assumption that considerations payable will be \$1000 per year. If not specified in the contract, annuity payments shall be assumed to commence at age 65 or ten years from issue, whichever is later. Zero amounts shall be displayed as zero and shall not be displayed as blank spaces.

#### Section 5. Disclosure Requirements

- A. The insurer shall provide to all prospective purchasers a Contract Summary prior to accepting the applicant's initial consideration for the annuity contract, or in the case of a deposit fund, prior to acceptance of the applicant's initial consideration for the associated life insurance policy or annuity contract, unless the annuity contract or associated life insurance policy for which application is made provides for an unconditional refund period of at least ten days or unless the Contract Summary contains such an unconditional refund offer, in which event the Contract Summary must be delivered with or prior to the delivery of the annuity contract or associated life insurance policy.
- B. The insurer shall provide a Contract Summary to any prospective purchaser upon request.

**Section 6. General Rules**

- A. Each insurer shall maintain at its home office or principal office, a complete file containing one copy of each document authorized by the insurer for use pursuant to this regulation. Such file shall contain one copy of each authorized form for a period of at least three years following the date of its last authorized use.
- B. An agent shall inform the prospective purchaser, prior to commencing a sales presentation, that the agent is acting as a life insurance agent and shall inform the prospective purchaser of the full name of the insurance company which the agent is representing to the buyer. In sales situations in which an agent is not involved, the insurer shall identify its full name.
- C. Terms such as financial planner, investment advisor, financial consultant or financial counseling shall not be used in such a way as to imply that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales, unless such is actually the case.
- D. Any reference to dividends or to excess interest credits must include a statement that such dividends or credits are not guaranteed.
- E. A presentation of benefits shall not display guaranteed and nonguaranteed benefits as a single sum unless guaranteed benefits are shown separately in close proximity thereto and with equal prominence.
- F. Sales promotion literature and contract forms shall not state or imply that annuity contracts or deposit funds are the same as savings accounts or deposits in banking or savings institutions. The use of passbooks which resemble savings bank passbooks is prohibited.

**Section 7. Failure to Comply**

Failure of an insurer to provide or deliver a Contract Summary as provided in section 5 shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an annuity contract or of an insurance policy.

**Section 8. Effective Date**

This rule shall apply to all solicitations which commence on or after (insert a date at least six months following adoption by the regulatory authority).

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Proposed Model Life Insurance Replacement Regulation

Exposure Draft  
June 1978

**Section 1. Statutory Authority**

This regulation is promulgated by (title of supervisory authority) to implement section \_\_\_\_\_ of the insurance laws.

**Section 2. Purpose**

The purpose of this regulation is:

- A. To regulate the activities of insurers and agents with respect to the replacement of existing life insurance.
- B. To protect the interests of life insurance policyowners by establishing minimum standards of conduct to be observed in the replacement or proposed replacement of existing life insurance by:

1. Assuring that the policyowner receives information with which a decision can be made in his or her own best interest.
2. Reducing the opportunity for misrepresentation and incomplete disclosures; and
3. Establishing penalties for failure to comply with the requirements of this regulation.

#### Section 3. Definition of Replacement

"Replacement" means any transaction in which new life insurance is to be purchased and it is known or should be known to the proposing agent, or to the proposing insurer if there is no agent, that by reason of such transaction, existing life insurance has been or is to be:

- A. Lapsed, forfeited, surrendered or otherwise terminated.
- B. Converted to reduced paid-up insurance, continued as extended term insurance or otherwise reduced in value by the use of nonforfeiture benefits or other policy values.
- C. Amended so as to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid.
- D. Reissued with any reduction in cash value.
- E. Pledged as collateral or subjected to borrowing, whether in a single loan or under a schedule of borrowing over a period of time, amounts exceeding 25% of the loan value set forth in the policy.

#### Section 4. Other Definitions

- A. "Existing Life Insurance" means any life insurance in force including life insurance under a binding or conditional receipt or a life insurance policy that is within an unconditional refund period, but excluding life insurance obtained through the exercise of a dividend option.
- B. "Existing Insurer" means the insurance company whose policy is or will be changed or terminated in such a manner as described within the definition of "replacement."
- C. "Replacing Insurer" means the insurance company that issues a new policy which is a replacement of existing life insurance.
- D. "Cash Dividend" means the current illustrated dividend which can be applied toward payment of the gross premium.
- E. "Generic Name" means a short title which is descriptive of the premium and benefit patterns of a policy or a rider.
- F. "Conservation" means any attempt by the existing insurer or its agent to continue existing life insurance in force when a sales proposal has been delivered to the applicant by the replacing insurer, agent or broker, or when the existing insurer or its agent has received a policy summary as required by section 7C4 of this regulation from a replacing insurer.
- G. "Sales Proposal" means individualized, written sales aids of all kinds which are used by an insurer, agent or broker in comparing existing life insurance to proposed life insurance in order to justify the replacement or conservation of existing life insurance. Sales aids of a generally descriptive nature, which are maintained in the insurer's advertising compliance file, shall not be considered a sales proposal within the meaning of this definition.
- H. "Direct-Response Sales" means any sale of life insurance where the insurer does not utilize an agent in the sale or delivery of the policy.

### Section 5. Exemptions

Unless otherwise specifically included, this regulation shall not apply to:

- A. Annuities.
- B. Individual credit life insurance.
- C. Group life insurance, group credit life insurance and 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.
- D. Variable life insurance under which the death benefits and cash values vary in accordance with unit values of investments held in a separate account.
- E. Where the application is made to the existing insurer that issued the existing life insurance and a contractual change or conversion privilege is being exercised.
- F. When the existing life insurance is a nonconvertible term life insurance policy which will expire in five years or less and cannot be renewed.
- G. When the proposed life insurance is to replace life insurance under a binding or conditional receipt issued by the same company.

### Section 6. Duties of Agents

- A. Each agent shall submit to the replacing insurer with or as part of each application for life insurance:
  - 1. A statement signed by the applicant as to whether or not such insurance will replace existing life insurance; and
  - 2. A signed statement as to whether or not the agent knows replacement is or may be involved in the transaction.
- B. Where a replacement is involved, the agent shall:
  - 1. Obtain with or as part of each application a list of all existing life insurance to be replaced. Such existing life insurance shall be identified by name of insurer and the policy number. In the event that a policy number has not been assigned by the existing insurer, alternative identification information, such as application or receipt number, must be listed.
  - 2. Present to the applicant, not later than at the time of taking the application, a "Notice Regarding Replacement of Life Insurance" in the form substantially as described in Exhibits A or B, whichever is applicable. The notice must be signed by the agent and receipt of it acknowledged by the applicant. A copy of the notice and the original or a copy of all sales proposals used for presentation to the applicant must be left with the applicant.
  - 3. Submit to the replacing insurer with the application, a copy of the "Notice Regarding Replacement of Life Insurance," signed by the agent and receipt of it acknowledged by the applicant, a copy of all sales proposals used for presentation to the applicant and a separate statement including the information described in section 6B1, unless such information is included in the application.
- C. Each agent who uses a sales proposal when conserving existing life insurance shall:
  - 1. Leave with the applicant the original or a copy of all sales proposals used in the conservation effort.
  - 2. Submit to the existing insurer a copy of all sales proposals used in the conservation effort.

Section 7. Duties of Replacing Insurers

Each replacing insurer shall:

- A. Inform its field representatives of the requirements of this regulation.
- B. Require with or as part of each completed application for life insurance:
  - 1. A statement signed by the applicant as to whether or not such insurance will replace existing life insurance; and
  - 2. A statement signed by the agent as to whether or not he or she knows replacement is or may be involved in the transaction.
- C. Where a replacement is involved:
  - 1. Require with or as part of each application for life insurance a list of all of the applicant's existing life insurance to be replaced. Such existing life insurance shall be identified by name of insurer and the policy number. In the event that a policy number has not been assigned by the existing insurer, alternative identification information, such as application or receipt number, must be listed.
  - 2. Require from the agent with the application for life insurance a copy of the "Notice Regarding Replacement of Life Insurance" signed by the agent and receipt of it acknowledged by the applicant, and a copy of all sales proposals used for presentation to the applicant.
  - 3. Unless otherwise modified by the provisions of sections 7C5 or 6 of this regulation, furnish to the applicant a policy summary in accordance with the provisions of the Life Insurance Solicitation Regulation.

*ALTERNATIVE PROVISION FOR SECTION 7C3*

*(If the NAIC Model Life Insurance Solicitation Regulation has not been promulgated, then, for the purpose of this regulation, the following alternative provision should be used.)*

- 3. Unless otherwise modified by the provisions of sections 7C5 or 6 of this regulation, furnish the applicant with a policy summary at or prior to the time of policy delivery. For the purpose of this regulation, a policy summary means a written statement describing the elements of the policy, including, but not limited to:
  - a. The name and address of the insurance agent or, if no agent is involved, a statement of the procedure to be followed in order to receive responses to inquiries regarding the policy summary.
  - b. The full name and home office or administrative office address of the company in which the life insurance policy is to be or has been written.
  - c. The generic name of the basic policy and each rider.
  - d. The following amounts, where applicable, for the first five policy years, the tenth and twentieth policy years, and at least one age from 60-65 or maturity, whichever is earlier:
    - (1) The annual premium for the basic policy.
    - (2) The annual premium for each optional rider.
    - (3) Guaranteed amount payable upon death, at the beginning of the policy year regardless of the cause of death other than suicide, or other specifically enumerated exclusions, which is provided under the basic policy and each rider shown separately.

- (4) Total guaranteed cash surrender values at the end of the year with values shown separately for the basic policy and each rider.
  - (5) Cash dividends payable to the end of the year with values shown separately for the basic policy and each rider. (Dividends need not be displayed beyond the twentieth policy year.)
  - (6) Guaranteed endowment amounts payable under the policy which are not included under guaranteed cash surrender values above.
- e. A policy summary which includes dividends shall also include a statement that dividends are based on the company's current dividend scale and are not guaranteed.
  - f. The effective policy loan annual percentage interest rate, if the policy contains such a loan provision, specifying whether this rate is applied in advance or in arrears. If the policy loan interest rate is variable, the policy summary is to include the maximum annual percentage rate.
  - g. The date on which the policy summary is prepared.
  - h. A statement to the effect that the presentation does not recognize that, because of interest, a dollar in the future has less value than a dollar today, unless the policy summary includes index figures which recognize the time value of money. If index figures are included in the policy summary, the applicant must be notified at the time the policy summary is delivered that such figures should only be used for comparing the relative costs of similar policies.

A policy summary must consist of a separate document. All information required to be disclosed must be set out in such a manner as not to minimize or render any portion thereof obscure. Any amounts which remain level for two or more years of the policy may be represented by a single number if it is clearly indicated what amounts are applicable for each policy year. Amounts in item 'd' in this section shall be listed in total, not on a per thousand nor per unit basis. If more than one insured is covered under one policy or rider, guaranteed death benefits shall be displayed separately for each insured or for each class of insureds if death benefits do not differ within the class. Zero amounts shall be displayed as zero and shall not be displayed as a blank space.

- 4. Send to the existing insurer a written communication that includes the name of the insured and the identification information with respect to the existing life insurance to be replaced that it obtained pursuant to section 7C1 within five working days of the date the application is received at its home or regional office, or the date its policy is issued, whichever is sooner.
- 5. Delay, if it is not also the existing insurer, the issue of its policy for 20 days after it sends the existing insurer a copy of the policy summary, unless it provides in its "Notice Regarding Replacement of Life Insurance" and in either its policy or in a separate written notice that is delivered with the policy that the applicant has a right to an unconditional refund of all premiums paid, which right may be exercised within a period of 20 days commencing from the date of delivery of the policy, and it sends the policy summary required by this section to the existing insurer within three working days of the date its policy is issued, in which event the replacing insurer may issue its policy immediately.
- 6. Provide, if it is also the existing insurer, the policyowner a policy summary for the new policy prepared in accordance with section 7C3, prior to accepting the applicant's initial premium or premium deposit, unless the replacing insurer provides in its "Notice Regarding Replacement of Life Insurance" and either its policy or in a separate written notice that is delivered with the policy that the applicant has a right to an unconditional refund of all premiums paid, which right may be exercised within a period of 20 days commencing from the date of delivery of the policy, in which event, the replacing insurer must furnish the policy summary at or prior to delivery of the policy.

7. Maintain copies of the written communication required by section 7C4, the "Notice Regarding Replacement of Life Insurance," the policy summary and all sales proposals used, and a replacement register, cross-indexed, by replacing agent and existing insurer to be replaced, 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.

#### Section 8. Duties of Insurers With Respect to Direct-Response Sales

Each insurer shall:

- A. Inform its responsible personnel of the requirements of this regulation.
- B. Require with or as part of each completed application for life insurance a statement signed by the applicant as to whether or not such insurance will replace existing life insurance.
- C. Where no replacement is proposed by an insurer in the solicitation of a direct-response sale and a replacement is involved: at the time the policy is mailed to the applicant, include a "Notice Regarding Replacement of Life Insurance" in a form substantially as described in Exhibit C.
- D. Where a replacement is proposed by an insurer in the solicitation of a direct-response sale and a replacement is involved:
  1. Request from the applicant with or as part of the application a list of all existing life insurance to be replaced. Such existing life insurance shall be identified by name of insurer.
  2. If the applicant furnishes the names of the existing insurers, then the replacing direct-response insurer shall mail the applicant a "Notice Regarding Replacement of Life Insurance" in a form substantially as described in Exhibit C within five working days after receipt of the application and shall comply with all of the provisions of sections 7C3, 4, 5, 6 and 7, except that it need not maintain a replacement register required by section 7C7.
  3. If the applicant does not furnish the names of the existing insurers, then the replacing direct-response insurer shall at the time the policy is mailed to the applicant, include a "Notice Regarding Replacement of Life Insurance" in a form substantially as described in Exhibit C.

#### Section 9. Duties of the Existing Insurer

Each existing insurer shall inform its responsible personnel of requirements of this regulation. Each existing insurer which undertakes a conservation effort shall:

- A. Furnish the policyowner with a policy summary for the existing life insurance within 20 days from the date it receives the policy summary required by section 7C5 from the replacing insurer. Such policy summary shall be completed in accordance with the provisions of the Life Insurance Solicitation Regulation, except that information relating to premiums, cash values, death benefits and dividends, if any, shall be computed from the current policy year of the existing life insurance. The policy summary shall include the amount of any outstanding policy indebtedness, the sum of any dividend accumulations or additions, and may include any other information that is not in violation of any regulation or statute. Life insurance cost index and equivalent level annual dividend figures need not be included in the policy summary. If index figures are included in the policy summary, the policyowner must be notified at the time the policy summary is delivered that such figures should only be used for comparing the relative costs of similar policies.

#### *ALTERNATIVE PROVISION FOR SECTION 9A*

*(If the NAIC Model Life Insurance Solicitation Regulation has not been promulgated, then, for the purposes of this regulation, the following alternative provision should be used for A.)*

- A. Furnish the policyowner with a policy summary for the existing life insurance within 20 days from the date it receives the policy summary required by section 7C5 from the replacing insurer. Such policy summary shall include all of the information required in section 7C3, except that information relating

to premiums, cash values, death benefits and dividends, if any, shall be computed from the current policy year of the existing life insurance. The policy summary shall include the amount of any outstanding policy indebtedness, the sum of any dividend accumulations or additions, and may include any other information that is not in violation of any regulation or statute.

- B. Furnish the replacing insurer with a copy of the policy summary for the existing life insurance within three working days of the date that the policy summary is sent by the existing insurer to either its agent or directly to the policyowner.
- C. Not be obligated to furnish a policy summary if the face amount of the existing life insurance policy is \$5000 or less.
- D. Maintain a file containing the following:
  1. Written communications required by section 7C4 and policy summaries required by section 7C5 received from replacing insurers; and
  2. Copies of policy summaries prepared pursuant to section 9A and all sales proposals used.

This material shall be indexed by the replacing insurer and held for three years or until the conclusion of the next regular examination conducted by the Insurance Department of its domicile, whichever is later.

#### Section 10. Penalties

- A. 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 \_\_\_\_\_.
- B. This regulation does not prohibit the use of additional material other than that which is required and that is not in violation of this regulation or any other \_\_\_\_\_ statute or regulation.
- C. Policyowners 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 policyowners who purchase the replacing policies from the same agent shall be deemed prima facie evidence of the agent's knowledge that replacement was intended in connection with the sale of those policies, and such patterns of action shall be deemed prima facie evidence of the agent's intent to violate this regulation.

#### EXHIBIT A

*(To be used where existing and proposed policies are written by different companies)*

Name, Address and Telephone Number of the Insurance Company \_\_\_\_\_

#### Important Notice Regarding Replacement of Life Insurance

Our agent is recommending to you that you purchase a life insurance policy from us. In connection with this purchase, you have indicated, either as a result of his recommendation or at your own initiative, that you may terminate or change your existing policy issued by another insurance company or that you may obtain a loan from that company against your policy to pay premiums on the proposed policy. Any of these actions is a replacement of life insurance, and this notice is required. Please read it carefully.

Whether it is to your advantage to replace your existing insurance coverage, only you can decide. It is in your best interest, however, to have adequate information before a decision to replace your present coverage becomes final so that you may understand the essential features of the proposed policy and of your existing insurance coverage.

To this end, we are required to give you a policy summary of the proposed policy no later than when the policy is delivered to you. In addition, we are required to notify the insurance company that issued your existing policy. That company may then furnish you with a similar policy summary of your existing policy. You may want to contact that company or its agents for additional information and advice or discuss your purchase with other advisors. The information you receive will be of value to you in reaching a final decision.

After we have received your application and notified the other insurance company (which we are required to do by state regulation at the time we issue your policy), you will have 20 days from the date the proposed policy is delivered to you to cancel the policy issued on your application and receive back all payments you made to us.

*(Alternate Paragraph if 20-Day Money-Back Guarantee is Not Provided)*

Please note that, by state regulation, we must delay the issuance of any policy which is intended to replace any of your existing insurance for 20 days from the date on which we send your existing insurer notification that their policy will be replaced.

You should recognize that a policy which has been in existence for a period of time may have certain advantages to you over a new policy. If the policy coverages are basically similar, the premiums for a new policy may be higher because rates increase as your age increases. Under your existing policy, the period of time during which the issuing company could contest the policy because of a material misstatement or omission on your application, or deny coverage for death caused by suicide, may have expired or may expire earlier than it will under the proposed policy. Your existing policy may have options which are not available under the policy being proposed to you or may not come into effect under the proposed policy until a later time during your life. Also, your proposed policy's cash values and dividends, if any, may grow slower initially because the company will incur the cost of issuing your new policy. On the other hand, the proposed policy may offer advantages which are more important to you.

If you are considering borrowing against your existing policy to pay the premiums on the proposed policy, you should understand that, in the event of your death, the amount of any unpaid loan, including unpaid interest, will be deducted from the benefits of your existing policy thereby reducing your total insurance coverage.

Caution

If, after studying the information made available to you, you do decide to replace the existing life insurance with our life insurance policy, you are urged not to take action to terminate or alter your existing life insurance coverage until after you have been issued the new policy, examined it and have found it to be acceptable to you. If you should terminate or otherwise materially alter your existing coverage and fail to qualify for the life insurance for which you have applied, you may find yourself unable to purchase other life insurance or able to purchase it only at substantially higher rates.

By \_\_\_\_\_  
Agent or Employee

I have received and read a copy of this Replacement Notice.

Signed \_\_\_\_\_ Date \_\_\_\_\_  
Applicant

EXHIBIT B

*(To be used where the existing and proposed policies are written by the same company)*

Name, Address and Telephone Number of the Insurance Company \_\_\_\_\_

Important Notice Regarding Replacement of Life Insurance

Our agent is recommending to you that you purchase a life insurance policy from us. In connection with this purchase, you have indicated, either as a result from his recommendation or at your own initiative, that you may terminate or change your existing policy issued by our company or that you may obtain a loan from our company against your existing policy to pay premiums on the proposed policy. Any of these actions is a replacement of life insurance, and this notice is required. Please read it carefully.

Whether it is to your advantage to replace your existing insurance coverage, only you can decide. It is in your best interest, however, to have adequate information before a decision to replace your present coverage becomes final so that you may understand the essential features of the proposed policy and of your existing insurance coverage.

To this end, we are required to give you a policy summary of the proposed policy no later than when the policy is delivered to you. In addition, we will, at your request, furnish you with a similar policy summary of your existing policy. You may want to discuss your purchase with other advisors. The information you receive will be of value to you in reaching a final decision.

*(Alternate Paragraph if 20-Day Money-Back Guarantee is Provided)*

After we have issued your policy, you will have 20 days from the date the new policy is delivered to you to cancel the policy issued on your application and receive back all payments you made to us.

You should recognize that a policy which has been in existence for a period of time may have certain advantages to you over a new policy. If the policy coverages are basically similar, the premiums for a new policy may be higher because rates increase as your age increases. Under your existing policy, the period of time during which our company could contest the policy because of a material misstatement or omission on your application, or deny coverage for death caused by suicide, may have expired or may expire earlier than it will under the proposed policy. Your existing policy may have options which are not available under the policy being proposed to you or may not come into effect under the proposed policy until a later time during your life. Also, your proposed policy's cash values and dividends, if any, may grow slower initially because the company will incur the cost of issuing your new policy. On the other hand, the proposed policy may offer advantages which are more important to you.

If you are considering borrowing against your existing policy to pay the premiums on the proposed policy, you should understand that in the event of your death, the amount of any unpaid loan, including unpaid interest, will be deducted from the benefits of your existing policy thereby reducing your total insurance coverage.

Caution

If, after studying the information made available to you, you do decide to replace the existing life insurance with our company with a new life insurance policy issued by our company, you are urged not to take action to terminate or alter your existing life insurance coverage until after you have been issued the new policy, examined it and have found it acceptable to you. If you should terminate or otherwise materially alter your existing coverage and fail to qualify for the life insurance for which you have applied, you may find yourself unable to purchase other life insurance or able to purchase it only at substantially higher rates.

By \_\_\_\_\_  
Agent or Employee

I have received and read a copy of this Replacement Notice.

Signed \_\_\_\_\_ Date \_\_\_\_\_  
Applicant

EXHIBIT C

Name, Address and Telephone Number of the Insurance Company \_\_\_\_\_

Important Notice Regarding Replacement of Life Insurance

You have indicated that you intend to replace an existing life insurance policy or policies in connection with the purchase of our life insurance policy. As a result, we are required to send you this notice. Please read it carefully.

Whether it is to your advantage to replace your existing insurance coverage, only you can decide. It is in your best interest, however, to have adequate information before a decision to replace your present coverage becomes final so that you may understand the essential features of the proposed policy and your existing insurance coverage.

You may want to contact your existing life insurance company or its agent for additional information and advice or discuss your purchase with other advisors. The information you receive should be of value to you in reaching a final decision.

You should recognize that a policy which has been in existence for a period of time may have certain advantages to you over a new policy. If the policy coverages are basically similar, the premiums for a new policy may be higher because rates increase as your age increases. Under your existing policy, the period of time during which the issuing company could [contest the policy because of a material misrepresentation or omission concerning medical information requested in your application, or] *(use bracketed language only when the application asks health questions)* deny coverage for death caused by suicide, may have expired or may expire earlier than it will under the proposed policy. Your existing policy may have options which are not available under the policy being proposed to you or may not come into effect under the proposed policy until a later time during your life. Also, your proposed policy's cash values and dividends, if any, may grow slower initially because the company will incur the cost of issuing your new policy. On the other hand, the proposed policy may offer advantages which are more important to you.

If you are considering borrowing against your existing policy to pay the premiums on the proposed policy, you should understand that in the event of your death, the amount of any unpaid loan, including unpaid interest, will be deducted from the benefits of your existing policy thereby reducing your total insurance coverage.

*(Alternate Paragraph if Direct-Response Insurer's Solicitation Proposes Replacement and a 20-Day Money-Back Guarantee is Provided by the Insurer)*

After we have issued your policy, you will have 20 days from the date the new policy is received by you to notify us you are cancelling the policy issued on your application, and you will receive back all payments you made to us.

You are urged not to take action to terminate or alter your existing life insurance coverage until you have been issued the new policy, examined it and have found it acceptable to you.

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To: Life Insurance (C3) Subcommittee

From: Robert J. Demichelis  
Associate General Counsel  
American Council of Life Insurance  
1850 K Street, N.W.  
Washington, D. C. 20006

Date: June 13, 1978

Re: NAIC Proposed Regulation on Replacement of Life Insurance

The American Council of Life Insurance is a national trade association of 476 United States and Canadian legal reserve life insurance companies, which have more than 93% of the life insurance in force in the United States.

The Council recognizes the need for regulation of life insurance replacements and believes very strongly that such regulation should be uniformly adopted in all states. The action by the NAIC in adopting a model regulation in 1970 was supported by the Council, but adoption of the model has varied significantly in the various states. The proposed changes to the model regulation represent the objective efforts of a knowledgeable group of life insurance executives and Insurance Department personnel. You are to be congratulated for your efforts. While the proposed regulation contains many improvements upon the present model regulation, the Council has strong reservations with respect to certain provisions.

Our principal objection is the elimination of the existing requirement for a "Comparison Statement" to be completed by the replacing agent prior to the taking of the application at the time of sale. We strongly urge that the "Comparison Statement" requirement be retained. Such a requirement places greater responsibility on the replacing agent for the representations he makes to encourage a replacement. It also serves to advise the existing insurer of the representations made at the time of sale, which is an essential ingredient to a conservation effort. Without a "Comparison Statement" the applicant will not have sufficient information at the time of sale to make an informed decision.

It should be recognized that although not all replacements are to the policyholder's disadvantage, valuable rights which have been earned under his existing policy may be forfeited. It is essential that complete and accurate information be provided prior to making an application for a new insurance purchase.

The Council would support an effort to dovetail the "Comparison Statement" to the "Policy Summary" mandated by the NAIC Life Insurance Solicitation Regulation, but urges that cost indices not be required on the existing policy. This is consistent with the Model Solicitation Regulation which urges that cost indices be used only to compare costs of similar policies.

The proposed regulation would permit the issuance of a replacement policy without timely notification to the existing insurer. The Council is of the opinion that this will encourage a greater number of replacements and will not be in the public interest, since it would lead to an increase in lapse rates and, ultimately, in the cost of insurance. Once a replacement sale has been consummated and the existing policy, insurer or agent have been discredited in the eyes of the policyholder, a reversal of that action will be extremely difficult, even if the replacement is shown to be disadvantageous to the policyholder. The Council recommends that the regulation be amended to require that notification of a proposed replacement be sent by the replacing insurer to the existing insurer immediately upon receipt of notification from the replacing agent.

The Council recommends that the regulation require the replacing insurer to delay issue of its policy for a period of 20 days, in order to allow the existing insurer, as well as the replacing insurer, enough time to present its case in an accurate, professional manner before the policyholder makes his final decision. Such a requirement is consistent with one of the stated objectives of the regulation, i.e. to establish an improved "competitive environment." Such requirement recognizes the investment the existing insurer has in its policy and the need for providing accurate information to the policyholder to make an informed decision.

The Council recommends that the proposed regulation be strengthened to provide for increased company responsibility for any violations of the regulation. We encourage adoption of special sanctions with regard to churning activities by agents who, upon leaving a company, replace business written with their former company. We also support the requirement in the regulation for maintenance of a replacement register which will assist companies in the self-regulation of replacement activities and should prove to be a useful enforcement tool for insurance regulators.

The Council's position is one of opposition to the proposed revision of the NAIC model regulation unless the amendments set forth in this statement are incorporated. With these amendments an orderly and competitive environment can be established which will benefit the insurance consumer. The regulation, as amended, would have the beneficial effect of providing accurate information and competent advice to the consumer; it would also recognize the rights of the existing insurer to conserve its relationship with its policyholder. The resulting regulation would thus be more balanced rather than the present proposal which is tilted in favor of the replacing insurer.

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(C3) Task Force on Revision of the Model Bill  
Defining Group Life Insurance and Development of a Model Bill  
Defining Group Health Insurance

June 13, 1978

At the December 1977 meeting of the (C3) Subcommittee, the American Council of Life Insurance (ACLI) requested a review of the NAIC Model Bill Defining Group Life Insurance which has been in existence since 1956. Pursuant to this request, this subcommittee appointed a task force to review the suggestions made by the ACLI and also to develop a model bill defining group health insurance.

Because of the time element, the task force has concentrated its efforts to date on the group life insurance definition and standard provisions.

The task force held an all day meeting in Baltimore on May 4, 1978 in conjunction with the industry advisory committee. The industry advisory committee endorsed the recommendations made to this subcommittee by the ACLI in December 1977. There was considerable discussion between the task force and the industry advisory committee of the reasons for the various recommendations made by the ACLI, and industry minority views were also voiced.

Our recommendations with respect to the model group life insurance law are contained in Exhibit A (underlined material represents suggested new language to be added to the present model law, and bracketed material designates the suggested deletions from the current provisions).

We believe our draft represents an equitable balance of the concerns of the public, the Commissioners and the insurance industry.

In the ACLI presentation made in December, your attention was called to the need for more flexibility in the group life definition and for the addition to the model bill of types of groups which have become prevalent since the original definition was published.

The task force agrees in principle with both of these objectives. Twenty years is a long time in the development of any matter as dynamic as insurance.

Although the report of your task force would provide greater flexibility than before, we have been somewhat more conservative than the ACLI in some of the changes we are recommending.

Some of the more important matters we have dealt with are as follows:

1. The ACLI recommended the elimination of the presently required 75% minimum participation in contributory employer groups. The task force recommends that this standard be maintained for smaller groups but relaxed for groups having at least 50 employees initially electing to join the program.
2. The ACLI recommended that the minimum number of lives required in an employer/employee case be reduced from ten to five. The task force agrees with this industry recommendation.
3. The present definition does not permit an employer/employee group in which the employees pay the entire cost of the insurance. Industry would remove this restriction. This task force, however, recommends that the requirement for participation by the group policyholder be retained for both employer/employee groups and for union-sponsored groups.
4. The industry advisory committee recommended the elimination of all dollar ceilings on amounts of insurance under group policies. This task force agrees with this point of view with respect to the amount of insurance on the employee or the insured member of an association. However, we do recommend limitations on amounts of insurance on the dependents of employees or members. The limits we recommend are \$20,000 on the life of a spouse and \$10,000 on the life of each child. We also recommend a limit of \$25,000 on the life of a debtor, except that this amount may be increased to \$100,000 if the debt represents a first mortgage loan on real estate. The task force recommendations are considerably in excess of the amounts permitted under the present model law, and the task force believes its recommendations are sufficiently liberal.
5. The present model limits to \$2000 the amount available on conversion from group to an individual policy when the group policy terminates. The industry recommends that this be increased to \$5000. Your task force recommends an increase to \$10,000. We believe that this figure is more in line with the increased amounts suggested for group coverage.
6. The ACLI recommended a new provision protecting persons during a period of total disability. The task force concurs with this recommendation and has enlarged it somewhat.
7. The task force recommendation follows the ACLI recommended definition in providing for new types of groups at the discretion of the Commissioner in the state in which the policies will be issued. The task force is strongly of the opinion, however, that the Commissioner in each state also should have a say in the solicitation in his state of novel types of groups issued elsewhere. For this reason, the task force has included in subsection IB(1) of the draft the additional requirement that solicitation under such discretionary groups may be made only with the permission of the Commissioner of each jurisdiction in which membership is to be solicited.
8. Furthermore, the task force believes that an insurer should not solicit group coverage in states in which it is not licensed (see subsection IB(2)). An exception to the licensing requirement is made, however, in the case of employer/employee and union groups where there may be legitimate reasons to allow group coverages in a state in which the carrier is not licensed.

As stated earlier, this task force has not yet had an opportunity to consider the model definition of group health insurance. We should like to point out, however, that the question has been raised as to whether a task force of the (C3) Subcommittee is the proper forum for an assignment regarding health insurance. We, therefore, respectfully request that this task force be relieved of responsibility with respect to developing a definition of group health insurance and that you request the chairman of the (C1) Subcommittee to appoint a task force for that purpose. If this is done, we will try to maintain such liaison with the (C1) task force as may be appropriate.

We further recommend that the (C3) Subcommittee receive this report, including Exhibit A, for publication in the minutes of this meeting so that there will be available an exposure draft of our recommendations, which we suggest should be acted on at the December 1978 meeting. In the intervening period, suggestions and comments can be forwarded to the Chairman of the task force for further review. Also, if there appears to be sufficient demand, the task force could hold a public hearing on the exposure draft. The task force will then be in a position to recommend to your subcommittee prior to your next meeting the adoption or modification of the suggested revisions.

The members of the task force are Sidney A. Green, Chairman, Maryland; James R. Montgomery III, District of Columbia; James H. Hunt, Massachusetts; and Thomas J. Kelly, New York. William A. White, New Jersey, was initially also a member but has since resigned. Irene Alpert, New York, provided considerable assistance to the task force by her participation.

The industry advisory committee consists of William F. Hannan, Chairman, Prudential Insurance Company of America; Gary W. Tolman, American National Insurance Company; Chester Zinn, Connecticut General Life Insurance Company; Robert L. Kelsey, John Hancock Mutual Life Insurance Company; James F. Nagle, Life Insurance Company of North America; Michael Marchese Jr., Lincoln National Life Insurance Company; Vincent P. Reusing, Metropolitan Life Insurance Company; Paul C. Latchford, Monumental Life Insurance Company; and H. James Douds, National Association of Life Underwriters.

The following persons from industry also participated in the May 4 hearing: John Meyerholz, American Council of Life Insurance; John Dineen, Health Insurance Association of America; Ronald Souders, Life Insurance Company of North America; Kenneth Yahne, Lincoln National Life Insurance Company; and William Albus, National Association of Life Underwriters.

Sidney A. Green, Chairman, Maryland; James R. Montgomery III, District of Columbia; James H. Hunt, Massachusetts; Thomas J. Kelly, New York.

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#### EXHIBIT A

##### Exposure Draft of Amendments to Group Life Insurance Definition and Group Life Insurance Standard Provisions Model Bill

*(Underlined material represents suggested new language. Bracketed material designates suggested deletions in the current language.)*

#### Section 1. Group Life Insurance Definition.

A. No policy of group life insurance shall be delivered in this state unless it conforms to one of the following descriptions:

[(A)] (1) A policy issued to an employer or to the trustees of a fund established by an employer, which employer or trustees shall be deemed the policyholder, to insure employees of the employer for the benefit of persons other than the employer, subject to the following requirements:

[(1)] (a) The employees eligible for insurance under the policy shall be all of the employees of the employer, or all of any class or classes thereof determined by conditions pertaining to their employment and family status. The policy may provide that the term "employees" shall include the employees of one or more subsidiary corporations, and the employees, individual proprietors, and partners of one or more affiliated corporations, proprietorships or partnerships if the business of the employer and of such affiliated corporations, proprietorships, or partnerships is under common control [through stock ownership or contract]. The policy may provide that the term "employees" shall include the individual proprietor or partners if the employer is an individual proprietorship or a partnership. The policy may provide that the term "employees" shall include retired employees. No director of a corporate employer shall be eligible for insurance under the policy unless such person is otherwise eligible as a bona fide employee of the corporation by performing services other than the usual duties of a director. [No individual proprietor or partner shall be eligible for insurance under the policy unless he is actively engaged in and devotes a substantial part of his time to the conduct of the business of the proprietor or partnership.] A policy issued to insure the employees of a public body may provide that the term "employees" shall include elected or appointed officials.

- {(2)} (b) The premium for the policy shall be paid by the policyholder, either [wholly] from the employer's funds [or funds contributed by him], or partly from such funds and partly from funds contributed by the insured employees. No policy may be issued on which the entire premium is to be derived from funds contributed by the insured employees. A policy on which part of the premium is to be derived from funds contributed by the insured employees may be placed in force only if at least (i) 75% of the then eligible employees[, excluding any as to whom evidence of individual insurability is not satisfactory to the insurer,] or (ii) 50 employees, whichever is less, elect to make the required contributions. Except as provided in Subsection (c), [A] a policy on which no part of the premium is to be derived from funds contributed by the insured employees must insure all eligible employees[, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer].
- (c) An insurer may exclude or limit the coverage on any person as to whom evidence of individual insurability is not satisfactory to the insurer.
- {(3)} (d) The policy must cover at least [10] five employees at date of issue.
- {(4)} (e) The amounts of insurance under the policy must be based upon one or more plans [some plan] precluding individual selection either by the employees or by the employer or trustees.
- {(B)} (2) A policy issued to a creditor or its parent holding company or to a trustee or trustees or agent designated by two or more creditors, which creditor, holding company, trustee, trustees or agent [who] shall be deemed the policyholder, to insure debtors of the creditor or creditors, subject to the following requirements:
- {(1)} (a) The debtors eligible for insurance under the policy shall be all of the debtors of the creditor or creditors [whose indebtedness is repayable either (i) in installments or (ii) in one sum at the end of a period not in excess of eighteen months from the initial date of debt], or all of any class or classes thereof[, determined by conditions pertaining to the indebtedness or to the purchase giving rise to the indebtedness]. The policy may provide that the term "debtors" shall include (i) borrowers of money or purchasers or lessees of goods, services, property, rights or privileges for which payment is arranged through a credit transaction, (ii) the debtors of one or more subsidiary corporations, and (iii) the debtors of one or more affiliated corporations, proprietorships or partnerships if the business of the policyholder and of such affiliated corporations, proprietorships or partnerships is under common control [through stock ownership, contract, or otherwise]. No debtor shall be eligible unless the indebtedness constitutes an irrevocable obligation to repay which is binding upon him during his lifetime, at and from the date the insurance becomes effective upon his life.
- {(2)} (b) The premium for the policy shall be paid by the policyholder, either from the creditor's funds, or from charges collected from the insured debtors, or from both. [A policy on which part or all of the premium is to be derived from the collection from the insured debtors of identifiable charges not required of uninsured debtors shall not include, in the class or classes of debtors eligible for insurance, debtors under obligations outstanding at the date of issue without evidence of individual insurability unless at least 75% of the then eligible debtors elect to pay the required charges.] Except as provided in Subsection (c), [A] a policy on which no part of the premium is to be derived from funds contributed by insured debtors specifically for their insurance [the collection of such identifiable charges] must insure all eligible debtors [or all except any as to whom evidence of individual insurability is not satisfactory to the insurer].
- {(3)} (c) [The policy may be issued only if the group of eligible debtors is then receiving new entrants at the rate of at least 100 persons yearly, or may reasonably be expected to receive at least 100 new entrants during the first policy year, and only if the policy reserves to the insurer the right to require evidence of individual insurability if less than 75% of the new entrants become insured.] An insurer may exclude any debtors as to whom evidence of individual insurability is not satisfactory to the insurer. The policy may include an age limitation. [The policy may exclude from the classes eligible for insurance classes of debtors determined by age.]
- {(4)} (d) [The amount of insurance on the life of any debtor shall at no time exceed the amount owed by him which is repayable in installments to the creditor, or \$10,000, whichever is less. Where the indebtedness is repayable in one sum to the creditor, the insurance on the life of any debtor shall in no instance be in effect for a period in excess of 18 months except that such insurance may be continued

for an additional period not exceeding six months in the case of default, extension or recasting of the loan.] The amount of the insurance on the life of any debtor shall at no time exceed the greater of the scheduled or actual amount of [the] unpaid indebtedness to the creditor [or \$10,000, whichever is less], provided further, however, that the amount of the insurance shall not exceed \$100,000 in the case of a first mortgage loan on real estate, or \$25,000 for any other class of loan.

- [(5)] (e) To the extent of the creditor's interest, [T] the insurance may [shall] be payable to the creditor or any successor to the right, title and interest of the creditor [policyholder]. Such payment shall reduce or extinguish the [unpaid indebtedness] credit obligation of the debtor to the extent of such payment. Whenever the amount of insurance exceeds the amount payable to the creditor, the excess shall be payable to a beneficiary, other than the creditor, named by the debtor, or to his estate.
- (f) Notwithstanding the provisions of the above subsections, insurance on agricultural credit transaction commitments may be written up to the amount of the loan commitment, but not in excess of \$25,000, on a nondecreasing or level term plan. Insurance on educational credit transaction commitments may be written up to the amount of the loan commitment, but not in excess of \$25,000, less the amount of any repayments made on the loan.
- [(C)] (3) A policy issued to a labor union, or similar employee organization, which shall be deemed the policyholder, to insure members of such union or organization for the benefit of persons other than the union or organization or any of its officials, representatives or agents, subject to the following requirements:
- [(1)] (a) The members eligible for insurance under the policy shall be all of the members of the union or organization, or all of any class or classes thereof determined by conditions pertaining to [their] employment, [or] to membership [in the union, or both] and/or to family status.
- [(2)] (b) The premium for the policy shall be paid by the policyholder, either [wholly] from funds of the union or organization [the union's funds], or partly from such funds and partly from funds contributed by the insured members specifically for their insurance. No policy may be issued on which the entire premium is to be derived from funds contributed by the insured members specifically for their insurance. [A policy on which part of the premium is to be derived from funds contributed by the insured members specifically for their insurance may be placed in force only if at least 75% of the then eligible members, excluding any as to whom evidence of individual insurability is not satisfactory to the insurer, elect to make the required contributions.] Except as provided in subsection (c), [A] a policy on which no part of the premium is to be derived from funds contributed by the insured members specifically for their insurance must insure all eligible members[, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer].
- [(3)] (c) An insurer may exclude or limit the coverage on any person as to whom evidence of individual insurability is not satisfactory to the insurer. [The policy must cover at least 25 members at date of issue.]
- [(4)] (d) The amounts of insurance under the policy must be based upon one or more plans [some plan] precluding individual selection either by the members or by the union or organization.
- [(D)] (4) A policy issued to the trustees of a fund established by two or more employers in the same industry, in related industries, or by one or more labor unions or similar organizations, or by one or more employers and one or more labor unions or similar employee organizations, which trustees shall be deemed the policyholder, to insure employees of the employers or members of the unions or organizations for the benefit of persons other than the employers or the unions or organizations, subject to the following requirements:
- [(1)] (a) The persons eligible for insurance shall be all of the employees of the employers or all of the members of the unions or organizations, or all of any class or classes thereof determined by conditions pertaining to [their] employment, [or] to membership [in the unions, or to both] and/or to family status. The policy may provide that the term "employees" shall include retired employees, elected and appointed officials if employees of a public body are insured, and the individual proprietor or partners if an employer is an individual proprietorship or a partnership. No director of a corporate employer shall be eligible for insurance under the policy unless such person is otherwise eligible as a bona fide employee of the corporation by performing services other than the usual duties of a director. [No

individual proprietor or partner shall be eligible for insurance under the policy unless he is actively engaged in and devotes a substantial part of his time to the conduct of the business of the proprietor or partnership.] The policy may provide that the term "employees" shall include the trustees or their employees, or both, if their duties are principally connected with such trusteeship.

- [(2)] (b) The premium for the policy shall be paid by the trustees [wholly] from funds contributed by the employer or employers of the insured persons, or by the union or unions or similar employee organizations, or by both, or from funds contributed by the insured persons and the employer or employers or union or unions or similar employee organizations. No policy may be issued on which [any part of] the entire premium is to be derived from funds contributed by the insured persons specifically for their insurance. Except as provided in subsection (c), [The] a policy on which no part of the premium is to be derived from funds contributed by the insured persons specifically for their insurance must insure all eligible persons[, or all except any as to whom evidence of individual insurability is not satisfactory to the insurer].
- [(3)] (c) An insurer may exclude or limit the coverage on any person as to whom evidence of individual insurability is not satisfactory to the insurer. [The policy must cover at date of issue at least 100 persons and not less than an average of five persons per employer unit; and if the fund is established by the members of an association of employers the policy may be issued only if (i) either (a) the participating employers constitute at date of issue at least 60% of those employer members whose employees are not already covered for group life insurance or (b) the total number of persons covered at date of issue exceeds 600; and (ii) the policy shall not require that, if a participating employer discontinues membership in the association, the insurance of his employees shall cease solely by reason of such discontinuance.]
- [(4)] (d) The amounts of insurance under the policy must be based upon one or more plans [some plan] precluding individual selection either by the covered [insured] persons or by the policyholder, employers, [or] unions or organizations.
- (5) A policy issued to an association or to the trustees of a fund established, created or maintained for the benefit of members of one or more associations all of whose eligible members have the same profession, trade or occupation, which association or associations shall have at the outset a minimum membership of 100 persons, a constitution and by-laws, shall have been organized and maintained in good faith for purposes other than that of obtaining insurance and shall have been in active existence for at least two years, subject to the following requirements:
- (a) The policy may insure members of such association or associations, employees thereof or employees of members, one or more of the preceding or all of any class or classes thereof determined by conditions pertaining to employment, to membership and/or to family status, for the benefit of persons other than the employees' employer, the association or associations, or any officials, representatives, trustees or agents thereof.
- (b) The premium for the policy shall be paid by the policyholder, from funds contributed by the association or associations, or by employer members, or by both, or from funds contributed by the covered persons or from both the covered persons and the association, associations, or employer members. Except as provided in subsection (c), a policy on which no part of the premium is to be derived from funds contributed by the covered persons specifically for their insurance must insure all eligible persons.
- (c) An insurer may exclude or limit the coverage on any person as to whom evidence of individual insurability is not satisfactory to the insurer.
- (d) The amounts of insurance under the policy must be based upon one or more plans precluding individual selection either by the covered persons, or by the policyholder, association or associations, employers or trustees.

- (6) A policy issued to a credit union or to a trustee or trustees or agent designated by two or more credit unions, which credit union, trustee, trustees or agent shall be deemed the policyholder, to insure members of such credit union or credit unions for the benefit of persons other than the credit union or credit unions, trustee or trustees, or agents or any of their officials, subject to the following requirements:
- (a) The members eligible for insurance shall be all of the members of the credit union or credit unions, or all of any class or classes thereof established for other than insurance purposes.
  - (b) The premium for the policy shall be paid by the policyholder, either from the credit union's funds, or from charges collected from the insured members, or from both. Except as provided in subsection (c), a policy on which no part of the premium is to be derived from charges collected from the covered members specifically for their insurance must insure all eligible members.
  - (c) An insurer may exclude or limit the coverage on any member as to whom evidence of individual insurability is not satisfactory to the insurer. The policy may include an age limitation.
  - (d) The amounts of insurance under the policy shall be based upon the shares or savings in the credit union of the members and such amounts of insurance may be determined according to the members' ages, but in no case shall the amount of insurance on any member exceed \$10,000.
- (7) A policy issued to a group other than those specified in subsections (1) through (6) of this section, if specifically authorized by the Commissioner, where conditions or circumstances indicate that granting such permission for discretionary group life insurance coverages is in the interest of public policy. The Commissioner shall refuse to grant such permission unless the insurer demonstrates to his satisfaction that the proposed group would be actuarially sound; would result in economies of acquisition and administration which justify a group rate; would not present hazards of voluntary adverse selection; and would provide amounts of insurance under the policy on the basis of one or more plans which preclude individual selection either by the covered persons or by the policyholder, employers, unions or trustees. The premium for the policy shall be paid by the policyholder, either from the policyholder's funds or from funds contributed by the covered persons, or from both. Premiums for the policy and any contributions by or on behalf of the insured persons must be reasonable in relation to the benefits provided. An insurer may exclude or limit the coverage on any person as to whom evidence of individual insurability is not satisfactory to the insurer.

B. Persons resident in this state shall not be enrolled in a policy of group life insurance delivered in another jurisdiction in violation of the following requirements, anything to the contrary in subparagraph (a)(5) of section 2 of the Unauthorized Insurers Model Statute notwithstanding.

- (1) Except if specifically authorized by the Commissioner, coverage may not be initially provided to any person resident in this state under a group life policy issued in another jurisdiction unless the policy conforms substantially to one of the types of groups specified in subsections A(1) through (6) of this section. The requirements for granting such authorization shall be the same as those set forth in subsection A(7) of this section.
- (2) Coverage may not be initially provided to any person resident in this state under a group life policy issued in another jurisdiction by an insurer not authorized to engage in life insurance business in this state unless the policy conforms substantially to the type of group specified in either subsection A(1) or subsection A(3) of this section.

Section 2. [Limits of Group Life Insurance] Dependent Group Life Insurance.

[No such policy of group life insurance may be issued to an employer, or labor union or to the trustees of a fund established in whole or in part by an employer or a labor union, which provides term insurance to any person which, together with any other term insurance under any group life insurance policy or policies issued to the employer or employers of such person or to a labor union or labor unions of which such person is a member or to the trustees of a fund or funds established in whole or in part by such employer or employers or such labor union or labor unions, exceeds \$20,000, unless 150% of the annual compensation of such person from his employer or employers exceeds \$20,000, in which event all such term insurance shall not exceed \$40,000 or 150% of such annual compensation whichever is the lesser.] Any group life insurance policy issued under section 1, other than one of the types specified in subsection A(2) or

A(6) of section 1, may be extended to insure the employees or members against loss due to the death of their spouses and dependent or minor children, or any class or classes thereof, established for other than insurance purposes, subject to the following:

- (1) The premium for the insurance shall be paid by the policyholder, either from funds contributed by the employer, union, association or other person to whom the policy has been issued, or from funds contributed by the covered persons, or from both. Except as provided in subsection (2), a policy on which no part of the premium for the dependent's coverage is to be derived from funds contributed by the covered persons must insure all eligible employees or members with respect to their spouses and dependent or minor children, or any class or classes thereof, established for other than insurance purposes.
- (2) An insurer may exclude or limit the coverage on any family member as to whom evidence of individual insurability is not satisfactory to the insurer.
- (3) The amounts of insurance under the policy may not exceed the lesser of (i) 50% of the amount of insurance for which the employee or member is covered, or (ii) \$20,000 in the case of a spouse or \$10,000 in the case of a dependent or minor child, and must be based upon one or more plans precluding individual selection either by the covered persons or by the policyholder, employers, unions, associations, or trustees.

### Section 3. Group Life Insurance Standard Provisions.

No policy of group life insurance shall be delivered in this state unless it contains in substance the following provisions, or provisions which in the opinion of the Commissioner are more favorable to the persons insured, or at least as favorable to the persons insured and more favorable to the policyholder, provided, however, (a) that provisions (6) to ~~(11)~~(10), inclusive, shall not apply to policies of the type specified in subsection A(2) of section 1 and that provisions (7) to (11) shall not apply to policies of the type specified in subsection A(6) of section 1 [issued to a creditor to insure debtors of such creditor]; (b) that the standard provisions required for individual life insurance policies shall not apply to group life insurance policies; and (c) that if the group life insurance policy is on a plan of insurance other than the term plan, it shall contain a nonforfeiture provision or provisions which in the opinion of the Commissioner is or are equitable to the insured persons and to the policyholder, but nothing herein shall be construed to require that group life insurance policies contain the same nonforfeiture provisions as are required for individual life insurance policies:

- (1) A provision that the policyholder is entitled to a grace period of 31 days for the payment of any premium due except the first, during which grace period the death benefit coverage shall continue in force, unless the policyholder shall have given the insurer written notice of discontinuance in advance of the date of discontinuance and in accordance with the terms of the policy. The policy may provide that the policyholder shall be liable to the insurer for the payment of a pro rata premium for the time the policy was in force during such grace period.
- (2) A provision that the validity of the policy shall not be contested except for nonpayment of premiums, after it has been in force for two years from its date of issue; and that no statement made by any person insured under the policy relating to his insurability shall be used in contesting the validity of the insurance with respect to which such statement was made after such insurance has been in force prior to the contest for a period of two years during such person's lifetime nor unless it is contained in a written instrument signed by him, provided, however, that no such provision shall preclude the assertion at any time of defenses based upon provisions in the policy which relate to eligibility for coverage.
- (3) A provision that a copy of the application, if any, of the policyholder shall be attached to the policy when issued, that all statements made by the policyholder or by the persons insured shall be deemed representations and not warranties, and that no statement made by any person insured shall be used in any contest unless a copy of the instrument containing the statement is or has been furnished to such person or, in the event of death or incapacity of the insured person, to his beneficiary or personal representative.
- (4) A provision setting forth the conditions, if any, under which the insurer reserves the right to require a person eligible for insurance to furnish evidence of individual insurability satisfactory to the insurer as a condition to part or all of his coverage.

- (5) A provision specifying an equitable adjustment of premiums or of benefits or of both to be made in the event the age of a person insured has been misstated, such provision to contain a clear statement of the method of adjustment to be used.
- (6) A provision that any sum becoming due by reason of the death of the person insured shall be payable to the beneficiary designated by the person insured, except that where the policy contains conditions pertaining to family status the beneficiary may be the family member specified by the policy terms, subject to the provisions of the policy in the event where there is no designated beneficiary, as to all or any part of such sum, living at the death of the person insured, and subject to any right reserved by the insurer in the policy and set forth in the certificate to pay at its option a part of such sum not exceeding \$2,500 [\$500] to any person appearing to the insurer to be equitably entitled thereto by reason of having incurred funeral or other expenses incident to the last illness or death of the person insured.
- (7) A provision that the insurer will issue to the policyholder for delivery to each person insured an individual certificate setting forth a statement as to the insurance protection to which he is entitled, to whom the insurance benefits are payable, a statement as to any dependent's coverage included in such certificate, and the rights and conditions set forth in (8), (9), [and] (10) and (11) following.
- (8) A provision that if the insurance, or any portion of it, on a person covered under the policy or on the dependent of a person covered, ceases because of termination of employment or of membership in the class or classes eligible for coverage under the policy, such person shall be entitled to have issued to him by the insurer, without evidence of insurability, an individual policy of life insurance without disability or other supplementary benefits, provided application for the individual policy shall be made, and the first premium paid to the insurer, within 31 days after such termination, and provided further that:
- (a) The individual policy shall, at the option of such person, be on any one of the forms, except term insurance, then customarily issued by the insurer at the age and for the amount applied for.
- (b) The individual policy shall be in an amount not in excess of the amount of life insurance which ceases because of such termination, less the amount of any life insurance for which such person becomes eligible under the same or any other group policy within 31 days after such termination, provided that any amount of insurance which shall have matured on or before the date of such termination as an endowment payable to the person insured, whether in one sum or in installments or in the form of an annuity, shall not, for the purposes of this provision, be included in the amount which is considered to cease because of such termination.
- (c) The premium on the individual policy shall be at the insurer's then customary rate applicable to the form and amount of the individual policy, to the class of risk to which such person belonged when initially enrolled in the group policy [then belongs], and to his age attained on the effective date of the individual policy.

Subject to the same conditions set forth above, the conversion privilege shall be available (i) to a surviving dependent, if any, at the death of the employee or member, with respect to the coverage under the group policy which terminates by reason of such death and (ii) to the dependent of the employee or member upon termination of coverage of the dependent, while the employee or member remains insured under the group policy, by reason of the dependent ceasing to be a qualified family member under the group policy.

- (9) A provision that if the group policy terminates or is amended so as to terminate the insurance of any class of insured persons, every person thereunder at the date of such termination whose insurance terminates, including the insured dependent of a covered person, and who has been so insured for at least five years prior to such termination date shall be entitled to have issued to him by the insurer an individual policy of life insurance, subject to the same conditions and limitations as are provided by (8) above, except that the group policy may provide that the amount of such individual policy shall not exceed the smaller of (a) the amount of the person's life insurance protection ceasing because of the termination or amendment of the group policy, less the amount of any life insurance for which he is or becomes eligible under any group policy issued or reinstated by the same or another insurer within 31 days after such termination, and (b) \$10,000 [\$2,000].

- (10) A provision that if a person insured under the group policy, or the insured dependent of a covered person, dies during the period within which he would have been entitled to have an individual policy issued to him in accordance with (8) or (9) above and before such an individual policy shall have become effective, the amount of life insurance which he would have been entitled to have issued to him under such individual policy shall be payable as a claim under the group policy, whether or not application for the individual policy or the payment of the first premium therefor has been made.
- (11) A provision that an insured person may continue coverage during the total disability of the insured person or dependent by timely payment to the policyholder of that portion, if any, of the premium that would have been required on behalf of the insured person had total disability not occurred. The continuation shall be on a premium paying basis for a period of six months from the date on which the total disability started, but not beyond the earlier of (a) approval by the insurer of continuation of the coverage under any disability provision which the group insurance policy may contain or (b) the discontinuance of the group insurance policy. Provided, however, that if the group policy has a qualification or waiting period for a disability benefit, the continuation shall extend in any event to the end of the qualification period even if the group policy has otherwise been discontinued.
- [(11)] (12) In the case of a policy of the type specified in subsection A(2) of section 1, [issued to a creditor to insure debtors of such creditor], a provision that the insurer will furnish to the policyholder for delivery to each debtor insured under the policy a form which will contain a statement that the life of the debtor is insured under the policy and that any death benefit paid thereunder by reason of his death shall be applied to reduce or extinguish the indebtedness.
- (13) In the case of a policy of the type specified in subsection A(6) of section 1, a provision that the insurer will issue to the policyholder for delivery to each person insured an individual certificate setting forth a statement as to the insurance protection to which he is entitled and to whom the insurance benefits are payable.

#### Section 4. Supplementary Bill Relating to Conversion Privileges

If any individual insured under a group life insurance policy hereafter delivered in this state becomes entitled under the terms of such policy to have an individual policy of life insurance issued to him without evidence of insurability, subject to making of application and payment of the first premium within the period specified in such policy, and if such individual is not given notice of the existence of such right at least 15 days prior to the expiration date of such period, then in such event the individual shall have an additional period within which to exercise such right, but nothing herein contained shall be construed to continue any insurance beyond the period provided in such policy. This additional period shall expire 15 days next after the individual is given such notice but in no event shall such additional period extend beyond ~~60~~ 90 days next after the expiration date of the period provided in such policy. Written notice presented to the individual or mailed by the policyholder to the last known address of the individual or mailed by the insurer to the last known address of the individual as furnished by the policyholder shall constitute notice for the purpose of this paragraph.

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(C3) Industry Advisory Committee  
on Revision of Model Group Life Insurance Laws

Baltimore, Maryland  
June 13, 1978

The industry advisory committee was appointed by task force Chairman, Sidney A. Green in mid-April. Since then we have had an opportunity to meet with the task force on just one occasion. That meeting took place in Baltimore on May 4, 1978.

At that meeting it was quite evident that the majority of the industry advisory committee members were in basic agreement with the recommendations presented to the (C3) Subcommittee by the American Council of Life Insurance at the December 1977 NAIC meeting. After a rather full discussion of the pros and cons of those recommendations, Mr. Green indicated that the task force would undertake its own redraft of the Group Life Definitions and Standard Provisions. The result of these efforts is reflected in the draft which the task force has presented to this subcommittee today.

Since the draft was only recently made available to the industry advisory committee, it has not been possible for us to discuss it in any depth before this meeting. However, we have no objections to the task force's recommendation that it be accepted as an exposure draft. We look forward to a continued dialogue with the task force and hope that we will be able to jointly develop a proposal which can be recommended for adoption by the NAIC at next December's meeting.

William F. Hannan, Chairman, Prudential Insurance Company of America; H. James Douds, National Association of Life Underwriters; Robert L. Kelsey, John Hancock Mutual Life Insurance Company; Paul C. Latchford, Monumental Life Insurance Company; Michael Marchese Jr., Lincoln National Life Insurance Company; James F. Nagle, Life Insurance Company of North America; Vincent P. Reusing, Metropolitan Life Insurance Company; Gary W. Tolman, American National Insurance Company; Chester Zinn, Connecticut General Life Insurance Company.

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

(C3) Life Insurance

SPECIAL REPORT  
May 1978

Actuarial Guidelines

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The (C) Committee Technical Task Force on Valuation and Nonforfeiture Value Regulation recommends that the (C3) Life Insurance Subcommittee adopt the four actuarial guidelines proposed in this Special Report and that such guidelines be recommended to the Financial Condition Examination (A5) Subcommittee for inclusion in the Financial Condition Examiners Handbook. Like all other materials included in the handbook, these guidelines are subject to possible modification in certain jurisdictions because of legislation peculiar to those jurisdictions. The four guidelines recommended are:

- A. Reserve requirements with respect to interest rate guarantees on active life funds held relative to group annuity contracts.
- B. Interpretation of minimum cash surrender benefit under the standard nonforfeiture law for individual deferred annuities having surrender charges for cash surrender.
- C. Interpretation regarding reserves for certain forms of term life insurance.
- D. Interpretation of the standard valuation law with respect to the valuation of policies whose valuation net premiums exceed the actual gross premium collected.

The texts of the first three guidelines are given in Attachments A, B and C. The fourth guideline is so brief that its text is included in this report.

A. Reserve Requirements With Respect to Interest Rate Guarantees on Active Life Funds Held Relative to Group Annuity Contracts

- 1. See Attachment A for the text of this guideline.
- 2. The purpose of this guideline is to provide a recommended uniform procedure for the valuation of group annuity active life funds which are accumulated at guaranteed rates of interest in excess of the statutory maximum guaranteed rates of interest permissible for the valuation of benefits purchased by group annuity funds. Most statutes, including the Standard Valuation Law, are silent on this procedure, and so the need for this guideline is established.

3. The guideline requires that the task force inform the NAIC Central Office by November 1 of each year the valuation interest assumption to be applied in the valuation of group annuity contributions received in the most recent calendar year. The NAIC Central Office will then update the table of valuation interest assumptions to be used with the guideline and distribute such updated table to the various Commissioners in time for use for the valuation of group annuity active life funds at the end of the year. This procedure is somewhat analogous to the present NAIC procedure for the Securities Valuation Manual prepared by the Securities Valuation Office of the NAIC.

**B. Interpretation of Minimum Cash Surrender Benefit Under the Standard Nonforfeiture Law for Individual Deferred Annuities**

1. See Attachment B for the text of this guideline.
2. The purpose of this guideline is to provide a recommended uniform interpretation of the provisions of the Standard Nonforfeiture Law for Individual Deferred Annuities with respect to individual deferred annuities with a surrender charge at maturity. At maturity of such contracts, either the annuitant may take the accumulated value without surrender charge and apply such accumulation to purchase an annuity, or the annuitant may surrender the annuity for cash and thereby receive the accumulated value less a surrender charge.

**C. Actuarial Interpretation Regarding Minimum Reserves for Certain Forms of Term Life Insurance**

1. See Attachment C for the text of this guideline.
2. The purpose of this guideline is to provide a practical interpretation for a uniform procedure for the valuation of renewable term insurance particularly for those plans where the valuation net premium exceeds the actual gross premium. The principal problem is that the 1958 CSO Mortality Table provides unrealistically high mortality assumptions with respect to current issues of renewable term insurance. The gross premium rates for such plans under a most strict interpretation of the present valuation statutes must be maintained at artificially high levels; otherwise, the insurer would incur a large drain on surplus. In addition to the text of the guideline, Attachment C1 entitled, "Proposed Recommendation by the American Council of Life Insurance on Deficiency Reserves for Renewable Term Insurance," further illustrates the need for this guideline.

**D. Interpretation of the Standard Valuation Law With Respect to the Valuation of Policies Whose Valuation Net Premiums Exceed the Actual Gross Premium Collected**

1. The purpose of this guideline (items 2 and 3 below) is to clarify the intent of the Standard Valuation Law.
2. The method of valuation promulgated by the model legislation adopted by the NAIC in December 1976 for the valuation of life insurance policies whose valuation net premiums exceed the actual gross premiums collected is a change in method of reserve calculation and not a change in reserve standards.
3. For policies so valued the maximum permissible valuation interest rate and the applicable mortality basis specified is that in effect at the date of issue of such policies.

John O. Montgomery, Chairman, California; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; William A. White, New Jersey; Thomas J. Kelly, New York; Robert Dolan, Pennsylvania; Ted Becker, Texas; Bradford S. Gile, Wisconsin.

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ATTACHMENT A

RESERVE REQUIREMENTS 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 calendar year "y" 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 funds, 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 not otherwise hold if these valuation procedures and standards did not apply, such company shall set up 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 1976, follow the procedure used at that time.
- (2) In calendar year 1976 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 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 table of values of  $i_{my}$  distributed each year by the Central Office of the National Association of Insurance Commissioners;

(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 the deduction under (1) of  $i_{py}$  shall be .01 instead of .005 and  $i_{my}$  for calendar years y + 1 through y + 10 shall be reduced by .005.

Table of Values of  $i_{my}$   
(Effective for the December 31, 1977 Valuation)

Calendar Year $y$ in Which Contributions Were Received*	Value of $i_{my}$ for Calendar Years $y + 1$ Through $y + 10$
1976	.089
1977	.087

\*Note: These factors were based upon gross new money rates for reporting annuity writing companies less .01

\*\*\*\*\*

ATTACHMENT B

INTERPRETATION OF MINIMUM CASH SURRENDER BENEFIT  
UNDER STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES

Section 6 of the model bill as written does not require that cash surrender benefits be paid; but where they are paid, it requires that such cash surrender benefits grade into maturity value using an interest rate not more than one percent higher than the rate specified in the contract for accumulating net considerations. While this method will be suited for contracts having a sales load at issue, it may create a problem for contracts having surrender charges for cash surrender.

For contracts providing cash surrender values, the cash surrender value at maturity shall be at least equal to the minimum nonforfeiture amount at maturity as defined in section 4. For purposes of calculating cash surrender values prior to maturity, the term "maturity value" in the Standard Nonforfeiture Law for Individual Deferred Annuities shall mean the cash surrender value at maturity.

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ATTACHMENT C

ACTUARIAL INTERPRETATION REGARDING MINIMUM RESERVES  
FOR CERTAIN FORMS OF TERM LIFE INSURANCE

**Scope.** This interpretation recommended by the NAIC Technical Task Force to Review Valuation and Nonforfeiture Value Regulation deals only with term life insurance without cash values which the owner has the unilateral right to maintain in force until its stated expiry date, subject only to the payment of required premiums which vary (generally increasing on a per \$1000 basis) during the term of the policy and under which premium rates are guaranteed to the stated final expiry. This interpretation applies only to such term plans valued on the 1958 CSO Mortality Table for the current term period.

Ten year renewable term, five year renewable term and one year renewable term or term to a stated age with generally increasing premiums are titles commonly given to such policies, but this interpretation concerns itself with the actual coverage provided and is not controlled by the name given the coverage.

**Background Information.** Historically, reserves on one year renewable term policies have consisted of a basic reserve for the current term period of one-half the cost of insurance for the current term period, plus a deficiency reserve, if any. The application of the Commissioners reserve valuation method to determine basic reserves and deficiency reserves for such policies is subject to varying interpretations as noted in Walter O. Menge's paper, "Commissioners Reserve Valuation Method" written at the time of construction of the Standard Valuation Law.

... the adaptation of the Commissioners reserve valuation method to fit policies for which the gross premium varies from year to year becomes a problem of generalization which, from a purely theoretical viewpoint, has an infinite number of possible solutions, some of which are practical and others of which are impractical.<sup>1</sup>

and

For these reasons, it seems desirable not to formulate at this time any fixed rules for the valuation of these unusual types of policies and riders. The second paragraph of section 4 of the Standard Valuation Law does not define the method of valuation of such contracts but requires that the method used, whatever it may be, must be consistent with that employed for uniform premium policies providing uniform insurance benefits, thus leaving open the possibility of a choice of several consistent methods.<sup>2</sup>

Acceptable Approaches. Two approaches to "consistent" reserves are suggested.

The unitary policy approach considers such policies as variable premium policies up to the mandatory expiry date. Under this approach the valuation net premiums are a uniform percentage of gross premiums with the percentage fixed at issue date. If appropriate deficiency reserves are held, this approach has great appeal. However, it is susceptible to manipulation and illogical results. Reserves according to this approach should be acceptable only if the company can demonstrate that actual reserves, including deficiency reserves, for all renewable term business valued using this approach are of the same general magnitude as would occur using an approved method as defined below.

The other approach is to hold policy reserves for only the current period of years (not necessarily equal to the renewal period) during which the required premium per \$1000 remains level, including deficiency reserves if appropriate. Additional reserves are established where net premiums, calculated on a basis which reflects current mortality, exceed gross premiums for future periods of level premiums. Although not speaking directly to valuation problems in this instance, the Hooker Committee report said:

The question was raised whether a policy providing term insurance for several years, automatically followed by permanent insurance, should be considered as two separate policies for the purpose of the Act. In the Committee's opinion, the respective portions may be treated separately if the portion providing permanent insurance takes the Company's regular rate at the then attained age. The rated age provision in the law appears to cover this point. However, the Committee draws a distinction between policies providing purely term insurance followed by permanent insurance at the company's published rate at the attained age of conversion, the policies providing for an initial premium such that the increased premium at a subsequent duration differs from that for a new policy at the attained age. The latter case obviously constitutes a single policy to which the formula should be applied at the outset.<sup>3</sup>

The second sentence of the above quotation lends support to the approach of separating successive periods of level premiums.

Under this interpretation, an approved method is any method which produces reserves greater than or equal to the sum of policy reserves, including deficiency reserves, for the current period of level premiums calculated on the basis of the applicable mortality and interest standards and reserve method specified in the Standard Valuation Law plus additional reserves calculated according to the following basis applied uniformly to all such policies.

The present value of the excess of test premiums for future periods of level premiums for which gross premiums are guaranteed over the respective gross premiums, such test premiums and present values being calculated on the mortality table attached to this interpretation and 4½% interest.

In case a future gross premium exceeds the test premium, the excess shall be considered zero and not a negative amount. This is in accordance with the principle of anticipating no future profits but providing for all future losses.

Reinsured Business. If reinsurance is assumed under an agreement in which the reinsurer reserves the right to raise premiums to a level at least as great as the net valuation premiums, the reinsurer is not required to establish deficiency reserves or additional reserves, and the ceding company is not permitted to take credit for such reserves on the portion of the business which is reinsured.

If a reinsurance agreement guarantees future reinsurance premiums, the reinsurer should establish deficiency reserves and additional reserves as required by this interpretation for the period for which reinsurance premiums are guaranteed, and the ceding company may take credit for such reserves against its deficiency and additional reserves on the portion of the business which is reinsured to the extent permitted by law.

Adequacy of Reserves. Although the above alternative is acceptable as meeting the intent of the Standard Valuation Law, this does not in any way relieve the certifying actuary of the insurance company from exercising his own best judgment with respect to the appropriate reserves. In particular, the actuary should consider term contracts of this nature when he states his opinion that aggregate reserves "make a good and sufficient provision for all unmaternity obligations of the company guaranteed under the terms of its policies" and "include provision for all actuarial reserves and related statement items which ought to be established."<sup>4</sup>

## References:

1. The Record, American Institute of Actuaries, Vol. XXXV, 1946, p. 270.
2. Ibid., p. 300.
3. 1947 NAIC Proceedings, 257.
4. Instructions for Completing NAIC Life and Health Annual Statement Blank, 1976, p. 1.

## MORTALITY RATES

The basic source of the rates is the modern CSO (TSA27, p. 624). These rates are age nearest birthday (ANB) rates, and age last birthday (ALB) rates were obtained by the same process as was used to obtain the 1958 CSO (ALB) rates. Beginning with the age 71 rates, these rates were interpolated into the 1958 CSO such that ages 75 and up are 1958 CSO rates.

The resulting  $q_x$  values were then individually subjected to a maximum of the 1958 CSO rates for males and the 1958 CSO rates set back six years for females (six-year setback according to the methods described in TSA11, p. 1060, for the three-year setback.)

	Male		Female	
	ANB	ALB	ANB	ALB
0	0.00498	0.0032443	0.00498	0.0032443
1	0.00150	0.0014700	0.00150	0.0014700
2	0.00144	0.0014001	0.00138	0.0013500
3	0.00136	0.0013300	0.00132	0.0012900
4	0.00130	0.0012701	0.00126	0.0012350
5	0.00124	0.0012151	0.00121	0.0011850
6	0.00119	0.0011701	0.00116	0.0011400
7	0.00115	0.0011349	0.00112	0.0011050
8	0.00112	0.0011150	0.00109	0.0010850
9	0.00111	0.0011100	0.00108	0.0010800
10	0.00111	0.0011150	0.00108	0.0010850
11	0.00112	0.0011350	0.00109	0.0010950
12	0.00115	0.0011751	0.00110	0.0011050
13	0.00120	0.0012349	0.00111	0.0011150
14	0.00127	0.0013100	0.00112	0.0013000
15	0.00135	0.0013899	0.00114	0.0011500
16	0.00143	0.0014699	0.00117	0.0011900
17	0.00151	0.0015550	0.00121	0.0012350
18	0.00160	0.0016400	0.00126	0.0012900
19	0.00168	0.0017149	0.00132	0.0013550
20	0.00175	0.0017850	0.00139	0.0014250
21	0.00182	0.0018449	0.00146	0.0015000
22	0.00186	0.0018749	0.00154	0.0015800
23	0.00189	0.0019000	0.00162	0.0016549
24	0.00191	0.0019199	0.00169	0.0017150
25	0.00193	0.0019450	0.00174	0.0017649
26	0.00196	0.0019750	0.00179	0.0018100
27	0.00199	0.0020099	0.00183	0.0018449
28	0.00203	0.0020549	0.00186	0.0018749
29	0.00208	0.0021049	0.00189	0.0019000
30	0.00212	0.0021350	0.00191	0.0019199

	Male		Female	
	ANB	ALB	ANB	ALB
31	0.00215	0.0021699	0.00193	0.0019450
32	0.00219	0.0022099	0.00196	0.0019750
33	0.00223	0.0022601	0.00199	0.0020099
34	0.00229	0.0023299	0.00203	0.0020549
35	0.00237	0.0024199	0.00208	0.0021049
36	0.00247	0.0025300	0.00213	0.0021600
37	0.00259	0.0026699	0.00219	0.0022199
38	0.00275	0.0028448	0.00225	0.0022850
39	0.00294	0.0030449	0.00232	0.0023600
40	0.00315	0.0032698	0.00240	0.0024549
41	0.00339	0.0035198	0.00251	0.0025750
42	0.00365	0.0037947	0.00264	0.0027199
43	0.00394	0.0040996	0.00280	0.0029049
44	0.00426	0.0044296	0.00301	0.0031297
45	0.00460	0.0047896	0.00325	0.0033898
46	0.00498	0.0051945	0.00353	0.0036848
47	0.00541	0.0056394	0.00384	0.0040048
48	0.00587	0.0061293	0.00417	0.0043496
49	0.00639	0.0066740	0.00453	0.0047245
50	0.00696	0.0072789	0.00492	0.0051345
51	0.00760	0.0079487	0.00535	0.0055894
52	0.00830	0.0086833	0.00583	0.0060941
53	0.00907	0.0094931	0.00636	0.0066541
54	0.00992	0.0103777	0.00695	0.0072739
55	0.01084	0.0113373	0.00760	0.0079586
56	0.01184	0.0123718	0.00832	0.0087133
57	0.01291	0.0134813	0.00911	0.0095330
58	0.01406	0.0146954	0.00996	0.0104227
59	0.01534	0.0160594	0.01089	0.0113922
60	0.01679	0.0176229	0.01190	0.0124467
61	0.01847	0.0194410	0.01300	0.0136010
62	0.02043	0.0215483	0.01421	0.0148703
63	0.02269	0.0239454	0.01554	0.0162642
64	0.02523	0.0265873	0.01700	0.0177882
65	0.02798	0.0294192	0.01859	0.0194568
66	0.03090	0.0323913	0.02034	0.0212802
67	0.03393	0.0354581	0.02224	0.0232634
68	0.03704	0.0386344	0.02431	0.0254260
69	0.04029	0.0419942	0.02657	0.0277884
70	0.04377	0.0456324	0.02904	0.0303751
71	0.04889	0.0509783	0.03175	0.0332207
72	0.05454	0.0568096	0.03474	0.0363609
73	0.06056	0.0629801	0.03804	0.0398247
74	0.06684	0.0694158	0.04168	0.0436032
75	0.07337	0.0761643	0.04561	0.0476512

	Male		Female	
	ANB	ALB	ANB	ALB
76	0.07918	0.0823059	0.04979	0.0519144
77	0.08570	0.0892151	0.05415	0.0563373
78	0.09306	0.0969267	0.05865	0.0608855
79	0.10119	0.1053509	0.06326	0.0656105
80	0.10998	0.1143924	0.06812	0.0706525
81	0.11935	0.1239481	0.07337	0.0761643
82	0.12917	0.1339226	0.07918	0.0823059
83	0.13938	0.1442973	0.08570	0.0892151
84	0.15001	0.1551241	0.09306	0.0969267
85	0.16114	0.1664679	0.10119	0.1053509
86	0.17282	0.1783921	0.10998	0.1143924
87	0.18513	0.1910205	0.11935	0.1239481
88	0.19825	0.2045732	0.12917	0.1339226
89	0.21246	0.2193681	0.13938	0.1442973
90	0.22814	0.2358223	0.15001	0.1551241
91	0.24577	0.2544375	0.16114	0.1664679
92	0.26593	0.2758218	0.17282	0.1783921
93	0.28930	0.3006685	0.18513	0.1910205
94	0.31666	0.3306957	0.19825	0.2045732
95	0.35124	0.3706446	0.21246	0.2193681
96	0.40056	0.4334881	0.22814	0.2358223
97	0.48842	0.5492489	0.24577	0.2544375
98	0.66815	0.7507962	0.26593	0.2758218
99	1.00000	1.0000000	0.28930	0.3006685
100			0.31666	0.3306957
101			0.35124	0.3706446
102			0.40056	0.4334881
103			0.48842	0.5492489
104			0.66815	0.7507962
105			1.00000	1.0000000

\*\*\*\*\*

## ATTACHMENT C1

Proposed Recommendation by the American Council of Life Insurance  
on Deficiency Reserves for Renewable Term Insurance

I. Purpose of the Recommendation

To develop a recommended uniform interpretation of deficiency reserve statutes as they apply to renewable term insurance.

II. Background

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 over the years renewable term insurance has come to mean term insurance under which the insured has a right to renew at specific guaranteed 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.

There are no clear guidelines for valuation of renewable term insurance, and a variety of interpretations exists between states and companies.

- A. Some states do not require reserves other than for a current term period; others have more conservative but differing interpretations.
- B. States have not generally distributed regulations or policy statements as to the interpretation of deficiency reserve laws. A single state may impose a conservative interpretation on one company and, in effect, by omission, a liberal interpretation on another company.
- C. Some states apply their interpretation of the deficiency reserve law on extra-territorial basis; others, apparently for business issued in the state only.
- D. The interpretation has an effect on pricing. Some companies are charging customers higher premiums than they think are necessary because they feel constrained by a conservative interpretation; other companies have priced assuming a liberal treatment and would find the product to be underpriced if they become subject retroactively to a conservative treatment.

### III. Work of the Council so Far

- A. We believe the valuation laws of the various states are not clear as to the treatment of renewable term insurance both with respect to basic reserves as well as deficiency reserves. This simple fact is the basic reason so many differing interpretations exist with respect to this business. This problem of varying interpretations of the reserve statute does not exist on permanent insurance. There is a consistent and uniform understanding of basic and deficiency reserve requirements for most permanent plans.
- B. The problem of very high deficiency reserves on term insurance which come out of conservative interpretations of the law results from the high assumed mortality rates of the obsolete 1958 CSO Mortality Table.

For example, additional reserves on this basis at age 45 on a competitively priced yearly renewable term plan to age 96 can run as high as \$31.67 per \$1000 on an initial premium per \$1000 of \$4.96. Use of a mortality table more representative of modern experience would reduce this additional reserve to \$.57 per \$1000 (see Attachment 1).

- C. The Council has considered carefully the "unitary policy" concept for renewable term insurance in making this recommendation. Under this concept, the policy is considered a single modified premium policy running from date of issue to the end of the final period for which premium rates are guaranteed.

Within this concept there are at least two frequently discussed ways of computing both basic and deficiency reserves:

- (i) Net premiums are calculated as a single uniform percentage of gross premiums from issue until the end of the final period for which premiums are guaranteed. Both basic reserves and deficiency reserves would be based on these premiums.
- (ii) Net premiums are computed for each period of level premiums separately, resulting in a series of net premiums which are not necessarily a constant percentage of gross premiums throughout but are a constant percentage of gross premiums within each period of level premiums. Both basic reserves and deficiency reserves would be based on these premiums.

Results will generally be different between the two approaches, except for plans which are deficient throughout under both definitions (in which case total reserves will simply equal present value of future benefits less present value of future gross premiums).

Approach (i) has theoretical appeal, but we discovered it may have a number of practical drawbacks, such as: (a) the fact that manipulation of gross premiums at later durations can eliminate the need for deficiency reserves; (b) basic reserves can be affected arbitrarily by the relative slope of the gross premium scale; and (c) basic reserves on two plans with identical benefits are equal only if the premiums for both plans are proportional.

We expect to do more studies, but have used approach (ii) as the basis for a proposed interim solution.

- D. The Council recognizes the need for a permanent solution to this problem and is willing to continue to work toward this goal. However, the current problem is a very urgent one, and we have concentrated on an immediate answer to it. We believe we have found an acceptable temporary solution. Our objectives in reaching it were as follows:
1. To find a practical solution which falls within the scope of existing law and, therefore, can be implemented immediately.
  2. To find an interpretation which is applicable under both existing law and the new NAIC model.
  3. To prevent an abrupt significant change in the surplus position to companies who, in the absence of direction to the contrary, priced their products based on a liberal interpretation of the law.
  4. To avoid manipulation of gross premiums at later durations for the purpose of eliminating or reducing deficiency reserves.
  5. To find a solution which will not, in an attempt to protect statutory solvency through overly conservative reserve requirements, unnecessarily increase the cost of renewable term insurance to the consumer.

#### IV. Findings

- A. Conservative interpretations of the current and proposed statutes are that the "premium paying period" in the law extends to the end of the period for which premiums are guaranteed. In the case of, for example, a five-year renewable term policy with premiums guaranteed to age 70 which increase at the end of each five years, the premium paying period would be "to age 70." This interpretation of the law would require deficiency reserves equal to the present value of deficiencies over that entire premium paying period.
- B. The most liberal interpretation of the statutes would allow "premium paying period" to be defined as the current period of level premiums of a policy. In the case of the five-year renewable term policy described above, the premium paying period would be considered to be five years.
- C. The Council fully recognizes the need for protection of the insured public through assuring the solvency of companies. However, we believe that deficiency reserves set up to the extent indicated by the most conservative method coupled with the 1958 CSO Mortality Table would be excessive.
- D. We, therefore, propose adoption of an interpretation of the law combined with additional requirements by directive such that the end result provides solvency protection but not to excess. At this point, it should be noted that actuarial certification provides overall insurance that the total reserves are adequate. This includes deficiency reserves.

#### V. Proposed Interim Solution

- A. We recommend that:
1. The NAIC, in recognition of the confusion which has existed around these laws in the past and which continues to exist, adopt the more liberal interpretation of the laws as defined in item IVB above as the official interpretation of the law. Deficiency reserves would be viewed as being required by statute (and therefore based on 1958 CSO mortality) only for the current period of level premiums where net premiums exceed gross premiums for such period; and
  2. The NAIC urges states to require by directive the establishment of additional reserves calculated according to the "conservative method" as described in item IVA, but using a mortality table more representative of modern experience. This directive would set up a model requirement that additional reserves be held in cases where net premiums on this modern basis exceed guaranteed gross premiums for future periods of level premiums. For this purpose, we suggest that the "Modern CSO" Mortality Table which has been used for testing purposes and is described in the *Transactions of the Society of Actuaries*, Vol. XXVII, 1975, p. 624, would serve as a reasonable approximation to a realistic modern valuation table until a new CSO table is developed. Precedent for the use of a table other than the 1958 CSO for computing reserves exists in cases such as group conversion, guaranteed insurability, etc.

- B. The "Modern CSO" Mortality Table and the maximum interest rate permitted by law should be used to compute net premiums to measure deficiencies in future periods of level premiums and also to take their present value in computing the additional reserve to be held.
- C. We emphasize again the fact that this solution is not intended to be a long term one. However, we believe it fulfills the objectives discussed earlier in this report during the period that a longer term solution is being developed.

#### ATTACHMENTS

Attachment 1 shows basic reserves, net premiums, deficiency reserves and total reserves for a competitively priced Annual Renewable Term to Age 96 policy.

These reserves are computed on the "unitary policy" concept described in item IIIC on pages 3 and 4 of the report. The reserves labeled "Single Policy" are calculated under approach (i) where net premiums are single uniform percentage of gross premiums throughout. The reserves labeled "Series of Policies" apply the "unitary policy" concept under approach (ii) where net premiums are computed for each period of level premiums separately.

Basis 1. Using 1958 CSO 3½% for basic reserves and deficiency reserves. These results show extremely large deficiency reserves and illustrate one practical difficulty of the "single policy" approach where the sufficiencies in later years significantly reduce the deficiencies.

Basis 2. Using 1958 CSO 3½% for basic reserves and 1958 CSO 4½% for deficiency reserves. These results show that use of the minimum standard (as provided in the latest NAIC model version of the law) provides little relief.

Basis 3. Using 1958 CSO 3½% for basic reserves and the "Modern CSO" Table (appearing on page 624 of Transactions of the Society of Actuaries, Vol. XXVII, 1975) and 3½% interest for deficiency reserves.

Basis 4. Same as Basis 3, but using 4½% interest for deficiency reserves.

Bases 3 and 4 on the "series of policies" approach illustrate the recommendation of the Council depending upon the table chosen to represent modern mortality.

Attachment 2 summarizes considerable basic research into the "unitary policy" question and illustrates the reason for our recommendation based on approach (ii) for calculating net premiums under this concept.

Attachment 3 discusses the specific language of the standard valuation law.

Attachment 4 illustrates the mortality margins in the "Modern CSO" Table as compared to the graduated 1965-70 intercompany experience taken from the Society of Actuaries Reports of Mortality and Morbidity Experience for 1966, 1968, 1970 and 1971 which reflects medically underwritten standard ordinary experience in policy years 6-15 and ultimate mortality for medical and nonmedical issues combined in policy years 16 and over. In this respect, the 65-70 graduated experience data is similar to the 1950-54 experience underlying the 1958 CSO Table which was graduated to form the 1958 CSO Basic Table. Absolute and percentage mortality margins are shown for the 1958 CSO Table as compared to graduated 1950-54 experience as compared to graduated 1965-70 experience. Similar mortality margins are shown for the "Modern CSO" Table as compared to graduated 1965-70 experience. The "Modern CSO" Table was constructed from the graduated 1965-70 experience using the same methodology as was used to construct the 1958 CSO Table from the graduated 1950-54 experience. Also shown are the actual mortality rates of the tables and of the graduated experience.

Attachment 5 is a draft Proposed Model Directive Regarding Minimum Reserves for Certain Forms of Term Life Insurance which would implement the recommendations of the American Council of Life Insurance [omitted here since it was incorporated into "Attachment C, Actuarial Interpretation Regarding Minimum Reserves," above].

## ATTACHMENT 1 TO ATTACHMENT C1

ART to Age 96  
Terminal Reserves Per \$1000

Issue Age: 25

Basis: 1

Valuation Basis for Basic Reserves: 1958 CSO 3½%

Valuation Basis for Deficiency Reserves: 1958 CSO 3½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	2.03	2.08	0.05	0.15	5.16	5.31	1.89	0.00	0.00	17.41	17.41
2	2.06	2.11	0.05	0.35	5.30	5.65	1.92	0.00	0.00	18.06	18.06
3	2.08	2.13	0.05	0.56	5.45	6.01	1.96	0.00	0.00	18.73	18.73
4	2.10	2.15	0.05	0.75	5.61	6.36	2.01	0.00	0.00	19.42	19.42
5	2.13	2.18	0.05	0.93	5.77	6.69	2.06	0.00	0.00	20.14	20.14
6	2.14	2.19	0.05	1.09	5.93	7.02	2.12	0.00	0.00	20.89	20.89
7	2.15	2.20	0.05	1.21	6.10	7.32	2.17	0.02	0.00	21.67	21.67
8	2.16	2.21	0.05	1.29	6.28	7.57	2.24	0.08	0.00	22.46	22.46
9	2.17	2.22	0.05	1.31	6.47	7.77	2.32	0.14	0.00	23.22	23.22
10	2.23	2.28	0.05	1.26	6.66	7.91	2.43	0.19	0.00	23.94	23.94
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15	3.05	3.12	0.07	0.63	7.71	8.34	3.41	0.36	0.00	27.65	27.65
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20	4.52	4.63	0.10	-1.24	8.90	8.90	5.17	0.64	0.00	31.08	31.08
.											
.											
25	6.91	7.07	0.15	-5.16	10.23	10.23	8.04	1.12	0.00	33.80	33.80
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30	10.75	10.99	0.24	-2.89	11.72	11.72	12.56	1.81	0.00	34.72	34.72
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Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
Terminal Reserves Per \$1000  
Issue Age: 45  
Basis: 1

Valuation Basis for Basic Reserves: 1958 CSO 3½%  
Valuation Basis for Deficiency Reserves: 1958 CSO 3½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	4.96	5.06	0.10	-0.58	7.88	7.88	5.63	0.67	0.00	31.67	31.67
2	5.41	5.52	0.10	-1.20	8.10	8.10	6.14	0.73	0.00	32.27	32.27
3	5.88	6.00	0.11	-1.90	8.33	8.33	6.71	0.83	0.00	32.86	32.86
4	6.37	6.50	0.12	-2.73	8.56	8.56	7.34	0.97	0.00	33.38	33.38
5	6.91	7.05	0.13	-3.73	8.80	8.80	8.04	1.12	0.00	33.80	33.80
6	7.61	7.76	0.15	-4.93	9.05	9.05	8.80	1.19	0.00	34.11	34.11
7	8.35	8.52	0.16	-6.23	9.30	9.30	9.62	1.27	0.00	34.39	34.39
8	9.10	9.28	0.17	-7.68	9.56	9.56	10.52	1.42	0.00	34.62	34.62
9	9.89	10.08	0.19	-9.33	9.82	9.82	11.50	1.60	0.00	34.74	34.74
10	10.75	10.96	0.21	-11.25	10.08	10.08	12.56	1.81	0.00	34.72	34.72
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15	16.82	17.15	0.32	-24.88	11.51	11.51	19.65	2.83	0.00	32.75	32.75
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.											
20	26.32	26.83	0.50	-50.64	13.15	13.15	30.68	4.35	0.00	24.52	24.52
.											
.											
25	44.08	44.93	0.84	-94.72	15.06	15.06	48.11	4.02	0.00	9.91	9.91
.											
.											
30	73.96	75.38	1.42	-160.23	17.24	17.24	70.89	0.00	0.00	0.00	0.00
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Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
Terminal Reserves Per \$1000  
Issue Age: 25  
Basis: 2

Valuation Basis for Basic Reserves: 1958 CSO 3½%  
Valuation Basis for Deficiency Reserves: 1958 CSO 4½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	2.03	2.08	0.05	0.15	3.97	4.12	1.88	0.00	0.00	11.82	11.82
2	2.06	2.12	0.05	0.35	4.10	4.45	1.90	0.00	0.00	12.38	12.38
3	2.08	2.14	0.05	0.56	4.25	4.80	1.94	0.00	0.00	12.96	12.96
4	2.10	2.16	0.05	0.75	4.39	5.15	1.99	0.00	0.00	13.57	13.57
5	2.13	2.19	0.05	0.93	4.55	5.47	2.04	0.00	0.00	14.21	14.21
6	2.14	2.20	0.05	1.09	4.71	5.80	2.10	0.00	0.00	14.89	14.89
7	2.15	2.21	0.05	1.21	4.87	6.09	2.15	0.00	0.00	15.59	15.59
8	2.16	2.22	0.05	1.29	5.05	6.34	2.22	0.06	0.00	16.33	16.33
9	2.17	2.23	0.05	1.31	5.23	6.54	2.30	0.12	0.00	17.04	17.04
10	2.23	2.29	0.05	1.26	5.43	6.68	2.40	0.17	0.00	17.73	17.73
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.											
15	3.05	3.13	0.07	0.63	6.51	7.14	3.38	0.32	0.00	21.33	21.33
.											
.											
20	4.52	4.64	0.11	-1.24	7.77	7.77	5.12	0.59	0.00	24.84	24.84
.											
.											
25	6.91	7.08	0.17	-5.16	9.24	9.24	7.96	1.05	0.00	27.88	27.88
.											
.											
30	10.75	11.02	0.26	-12.89	10.91	10.91	12.44	1.69	0.00	29.36	29.36
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Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
Terminal Reserves Per \$1000

Issue Age: 45

Basis: 2

Valuation Basis for Basic Reserves: 1958 CSO 3½%

Valuation Basis for Deficiency Reserves: 1958 CSO 4½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	4.96	5.09	0.12	-0.58	8.01	8.01	5.58	0.61	0.00	25.47	25.47
2	5.41	5.55	0.13	-1.20	8.30	8.30	6.09	0.67	0.00	26.13	26.13
3	5.88	6.03	0.14	-1.90	8.59	8.59	6.65	0.77	0.00	26.77	26.77
4	6.37	6.53	0.15	-2.73	8.89	8.89	7.27	0.90	0.00	27.37	27.37
5	6.91	7.08	0.17	-3.73	9.19	9.19	7.96	1.05	0.00	27.88	27.88
6	7.61	7.80	0.18	-4.93	9.51	9.51	8.72	1.10	0.00	28.27	28.27
7	8.35	8.56	0.20	-6.23	9.84	9.84	9.53	1.18	0.00	28.65	28.65
8	9.10	9.33	0.22	-7.68	10.17	10.17	10.42	1.32	0.00	29.00	29.00
9	9.89	10.14	0.24	-9.33	10.51	10.51	11.39	1.49	0.00	29.25	29.25
10	10.75	11.02	0.26	-11.25	10.86	10.86	12.44	1.69	0.00	29.36	29.36
.											
15	16.82	17.23	0.41	-24.88	12.75	12.75	19.46	2.64	0.00	28.24	28.24
.											
20	26.32	26.96	0.64	-50.64	14.96	14.96	30.38	4.06	0.00	21.16	21.16
.											
25	44.08	45.15	1.07	-94.72	17.55	17.55	47.65	3.56	0.00	8.02	8.02
.											
30	73.96	75.76	1.79	-160.23	20.51	20.51	70.21	0.00	0.00	0.00	0.00
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Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
Terminal Reserves Per \$1000  
Issue Age: 25  
Basis: 3  
Valuation Basis for Basic Reserves: 1958 CSO 3½%  
Valuation Basis for Deficiency Reserves: Modern CSO 3½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	2.03	1.86	0.00	0.15	0.00	0.15	1.96	0.00	0.00	0.36	0.36
2	2.06	1.88	0.00	0.35	0.00	0.35	1.99	0.00	0.00	0.37	0.37
3	2.08	1.90	0.00	0.56	0.00	0.56	2.01	0.00	0.00	0.39	0.39
4	2.10	1.92	0.00	0.75	0.00	0.75	2.03	0.00	0.00	0.40	0.40
5	2.13	1.95	0.00	0.93	0.00	0.93	2.05	0.00	0.00	0.41	0.41
6	2.14	1.96	0.00	1.09	0.00	1.09	2.08	0.00	0.00	0.43	0.43
7	2.15	1.97	0.00	1.21	0.00	1.21	2.12	0.00	0.00	0.45	0.45
8	2.16	1.98	0.00	1.29	0.00	1.29	2.15	0.00	0.00	0.46	0.46
9	2.17	1.99	0.00	1.31	0.00	1.31	2.21	0.04	0.00	0.48	0.48
10	2.23	2.04	0.00	1.26	0.00	1.26	2.29	0.05	0.00	0.46	0.46
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.											
15	3.05	2.79	0.00	0.63	0.00	0.63	3.04	0.00	0.00	0.45	0.45
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.											
20	4.52	4.13	0.00	-1.24	0.00	0.00	4.44	0.00	0.00	0.54	0.54
.											
.											
25	6.91	6.31	0.00	-5.16	0.00	0.00	6.72	0.00	0.00	0.66	0.66
.											
.											
30	10.75	9.82	0.00	-12.89	0.00	0.00	10.47	0.00	0.00	0.82	0.82
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Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
 Terminal Reserves Per \$1000  
 Issue Age: 45  
 Basis: 3

Valuation Basis for Basic Reserves: 1958 CSO 3½%  
 Valuation Basis for Deficiency Reserves: Modern CSO 3½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def Reserve	Total Reserve*
1	4.96	4.47	0.00	-0.58	0.00	0.00	4.81	0.00	0.00	0.57	0.57
2	5.41	4.88	0.00	-1.20	0.00	0.00	5.23	0.00	0.00	0.59	0.59
3	5.88	5.30	0.00	-1.90	0.00	0.00	5.67	0.00	0.00	0.61	0.61
4	6.37	5.74	0.00	-2.73	0.00	0.00	6.17	0.00	0.00	0.64	0.64
5	6.91	6.23	0.00	-3.73	0.00	0.00	6.72	0.00	0.00	0.66	0.66
6	7.61	6.86	0.00	-4.93	0.00	0.00	7.34	0.00	0.00	0.69	0.69
7	8.35	7.52	0.00	-6.23	0.00	0.00	8.02	0.00	0.00	0.72	0.72
8	9.10	8.20	0.00	-7.68	0.00	0.00	8.76	0.00	0.00	0.75	0.75
9	9.89	8.91	0.00	-9.33	0.00	0.00	9.58	0.00	0.00	0.79	0.79
10	10.75	9.69	0.00	-11.25	0.00	0.00	10.47	0.00	0.00	0.82	0.82
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15	16.82	15.15	0.00	-24.88	0.00	0.00	16.22	0.00	0.00	1.04	1.04
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20	26.32	23.71	0.00	-50.64	0.00	0.00	27.03	0.71	0.00	1.07	1.07
.											
.											
25	44.08	39.70	0.00	-94.72	0.00	0.00	42.29	0.00	0.00	0.00	0.00
.											
.											
30	73.96	66.61	0.00	-160.23	0.00	0.00	65.13	0.00	0.00	0.00	0.00
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Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
Terminal Reserves Per \$1000  
Issue Age: 25  
Basis: 4

Valuation Basis for Basic Reserves: 1958 CSO 3½%  
Valuation Basis for Deficiency Reserves: Modern CSO 4½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	2.03	1.86	0.00	0.15	0.00	0.15	1.94	0.00	0.00	0.12	0.12
2	2.06	1.89	0.00	0.35	0.00	0.35	1.97	0.00	0.00	0.12	0.12
3	2.08	1.91	0.00	0.56	0.00	0.56	1.99	0.00	0.00	0.13	0.13
4	2.10	1.93	0.00	0.75	0.00	0.75	2.01	0.00	0.00	0.14	0.14
5	2.13	1.95	0.00	0.93	0.00	0.93	2.03	0.00	0.00	0.14	0.14
6	2.14	1.96	0.00	1.09	0.00	1.09	2.06	0.00	0.00	0.15	0.15
7	2.15	1.97	0.00	1.21	0.00	1.21	2.10	0.00	0.00	0.16	0.16
8	2.16	1.98	0.00	1.29	0.00	1.29	2.13	0.00	0.00	0.16	0.16
9	2.17	1.99	0.00	1.31	0.00	1.31	2.19	0.02	0.00	0.17	0.17
10	2.23	2.04	0.00	1.26	0.00	1.26	2.27	0.03	0.00	0.16	0.16
.											
.											
15	3.05	2.79	0.00	0.63	0.00	0.63	3.01	0.00	0.00	0.15	0.15
.											
.											
20	4.52	4.14	0.00	-1.24	0.00	0.00	4.40	0.00	0.00	0.20	0.20
.											
.											
25	6.91	6.32	0.00	-5.16	0.00	0.00	6.66	0.00	0.00	0.25	0.25
.											
.											
30	10.75	9.84	0.00	-12.89	0.00	0.00	10.37	0.00	0.00	0.33	0.33
.											
.											

Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

ART to Age 96  
Terminal Reserves Per \$1000  
Issue Age: 45  
Basis: 4

Valuation Basis for Basic Reserves: 1958 CSO 3½%  
Valuation Basis for Deficiency Reserves: Modern CSO 4½%

Dur.	Single Policy						Series of Policies				
	Gross Prem.	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*	Net Prem.	Def.	Basic Reserve	Def. Reserve	Total Reserve*
1	4.96	4.47	0.00	-0.58	0.00	0.00	4.77	0.00	0.00	0.21	0.21
2	5.41	4.87	0.00	-1.20	0.00	0.00	5.18	0.00	0.00	0.22	0.22
3	5.88	5.30	0.00	-1.90	0.00	0.00	5.62	0.00	0.00	0.23	0.23
4	6.37	5.74	0.00	-2.73	0.00	0.00	6.11	0.00	0.00	0.24	0.24
5	6.91	6.23	0.00	-3.73	0.00	0.00	6.66	0.00	0.00	0.25	0.25
6	7.61	6.86	0.00	-4.93	0.00	0.00	7.27	0.00	0.00	0.26	0.26
7	8.35	7.52	0.00	-6.23	0.00	0.00	7.94	0.00	0.00	0.28	0.28
8	9.10	8.20	0.00	-7.68	0.00	0.00	8.68	0.00	0.00	0.29	0.29
9	9.89	8.91	0.00	-9.33	0.00	0.00	9.49	0.00	0.00	0.31	0.31
10	10.75	9.68	0.00	-11.25	0.00	0.00	10.37	0.00	0.00	0.33	0.33
.											
.											
15	16.82	15.15	0.00	-24.88	0.00	0.00	16.07	0.00	0.00	0.43	0.43
.											
.											
20	26.32	23.70	0.00	-50.64	0.00	0.00	26.78	0.45	0.00	0.54	0.54
.											
.											
25	44.08	39.69	0.00	-94.72	0.00	0.00	41.89	0.00	0.00	0.00	0.00
.											
.											
30	73.96	66.58	0.00	-160.23	0.00	0.00	64.51	0.00	0.00	0.00	0.00
.											
.											

Single Policy. Net premiums are calculated as a constant percentage of gross premiums to age 96. Basic reserves are based on these net premiums and calculated for a benefit period running to age 96. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above.

Series of Policies. Net premiums are calculated as a series of net level premiums for one-year term insurance. Basic reserves are based on these net premiums and calculated for a benefit period of one year. Deficiency reserves are based on net premiums calculated on this basis and with "the remainder of the premium-paying period" being "to age 96." The net premiums used in the deficiency reserve calculation are shown above. No sufficiencies offset deficiencies.

\*Total reserve is calculated assuming negative basic reserves set equal to zero.

## ATTACHMENT 2 TO ATTACHMENT C1

This attachment consists of three tables describing the results of calculations of a Basic Reserve, a Deficiency Reserve and a Total Reserve on two reserve methods: (1) Uniform Percentage Method (referred to in IIIC(i) of the recommendation) and (2) Period of Level Premiums Method (referred to in IIIC(ii) of the recommendation).

In the Basic Reserve Calculation, negative terminal reserves were set equal to zero. It has the usual mean reserve floor of half the net premium. Also, the Total Reserve under the Uniform Percentage Method has a mean reserve floor of half the net premium if there are no deficiency reserves and half the gross premium if there are deficiency reserves. In certain cases, this generates mean reserves that are less than half the cost of insurance.

The three tables that are attached consist of:

Table I	Some definitions and a description of the approach used.
Table II	Some general observations.
Table III	Some comments on the two reserve methods of 16 cases that were analyzed.

Table I  
One Year Renewable Term Insurance Reserves

We have made a number of calculations of mean reserves using two different methods. The results are attached. The plan chosen was YRT to 95, issue age 35. The mortality table was 1958 CSO and the interest rate was 3½%. First, some definitions, then a description of the two methods.

$GP_t$	Gross Premium for $t$ th policy year.
$YRTNP_t$	Yearly Renewable Term Net Premium for $t$ th policy year.
$UNP_t$	Uniform Percent Net Premium for $t$ th policy year.
UR	Uniform Ratio that the present value of all future GP's is to the present value of future UNP's -- at issue. Note this definition is the reciprocal of the "uniform percentage" referred to in the Standard Valuation Law.

Mean Reserves

1. Period of Level Premiums Method (referred to as "YRT Method" for this plan)
  - (a) Basic Reserve uses valuation net premiums that equal the one year term cost of insurance, i.e.  $(C_x \div D_x)$ . These reserves are not affected by either the "slope" of the actual gross premiums or their "size." Mean reserve is half the net.
  - (b) Deficiency Reserve is the present value of future deficiencies. Sufficiencies are not used to offset deficiencies.
  - (c) Total Reserve is (a) + (b).
2. Uniform Percentage Method
  - (a) Basic Reserve uses valuation net premiums that are a uniform percentage of the actual gross premium. The "slope" of the gross premium scale does affect each valuation net premium and, therefore, the reserve.
    - (i) Formula Mean was calculated using the normal reserve formula.
    - (ii) Actual Mean equals the larger of (i) and one half of UNP.
  - (b) Deficiency Reserve is zero at all durations if the Uniform Ratio (UR) is greater than, or equal to, 1.00 and of some positive value at each duration if the Uniform Ratio (UR) is less than 1.00.
  - (c) Total Reserve = Actual Mean if there are no Deficiency Reserves.  
= The larger of (½GP) and (Formula Mean plus Deficiency Reserve), if there are Deficiency Reserves.

Table II  
Some General Observations

1. The Basic Reserve on the Uniform Percentage Method in the first policy year is greater than that under the YRT Method if  $UNP_1 > YRTNP_1$ . This is the same as  $\frac{GP_1}{YRTNP_1} > \frac{GP_1}{UNP_1} = UR$ .
2. The Basic Reserve on the Uniform Percentage Method in the first policy year is negative if  $UNP_1 < YRTNP_1$ . In fact if the first m UNP's are each less than the first m YRTNP's, the Basic Reserves on the Uniform Percentage Method will be negative. Also if the last n UNP's are each greater than the last n YRTNP's, the Basic Reserves on the Uniform Percentage Method will be negative.
3. UNP's cannot be always less (or always greater) than YRTNP's, as their present value at issue are equal. The relative size of UNP and YRTNP must, therefore, change at least once during the life of the policy.
4. If there are Deficiency Reserves on the Uniform Percentage Method, they will occur at all durations. This means there must be Deficiency Reserves at some durations on the YRT method as each of the YRTNP's cannot be less than each of the deficient UNP's as their present values at issue are equal.
5. If there are Deficiency Reserves on the Uniform Percentage Methods, Total Reserves are equal on both methods, beginning at that duration where all future YRTNP's are all deficient.

Table III

Case I

GP is 1.10 of YRTNP at all durations

$$UR = 1.10$$

$$\frac{UNP_1}{YRTNP_1} = \frac{1.10}{1.10} = 1$$

Basic Reserves on YRT and Uniform Percentage Methods are equal as  $UNP = YRTNP$  at all durations.

There are no Deficiency Reserves generated under either method.

Total Reserves are equal on both methods.

+++++

Case II

GP is .95 of YRTNP at all durations

$$UR = .95$$

$$\frac{UNP_1}{YRTNP_1} = \frac{.95}{.95} = 1$$

Basic Reserves on YRT and Uniform Percentage Methods are equal as  $UNP = YRTNP$  at all durations.

There are Deficiency Reserves at all durations on both methods and they are equal.

Total Reserves are equal on both methods.

+++++

Case III

GP grades from 1.02 to 1.10 of YRTNP

$$\begin{aligned} \text{UR} &= 1.06 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{1.02}{1.06} < 1 \end{aligned}$$

The UNP's are all less than YRTNP's for the first 31 durations, so a retrospective reserve calculation produces negative terminal reserves. Thus, the mean reserve is one half a lower net premium on the Uniform Percentage Method. The UNP's are all greater than YRTNP's for the last 29 durations, so a prospective reserve calculation also produces negative terminal reserves, so the mean reserve is set equal to one half a larger net premium on the Uniform Percentage Method.

There are no Deficiency Reserves generated under either method.

Total Reserves equal Basic Reserves.

+++++

Case IV

GP grades from 1.10 to 1.02 of YRTNP

$$\begin{aligned} \text{UR} &= 1.06 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{1.10}{1.06} > 1 \end{aligned}$$

Basic Reserves on Uniform Percentage Method are always greater as UNP's are all greater than YRTNP's for the first 31 durations and all less thereafter.

There are no Deficiency Reserves generated under either method.

Total Reserves are greater on the Uniform Percentage Method.

+++++

Case V

GP grades from .98 to .95 of YRTNP

$$\begin{aligned} \text{UR} &= .96 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{.98}{.96} > 1 \end{aligned}$$

Basic Reserves on Uniform Percentage Method are always greater as UNP's are all greater than YRTNP's for the first 31 durations and all less thereafter.

Total Reserves are equal on both methods due to Deficiency Reserves

There are Deficiency Reserves at all durations on both methods, but they are smaller on the Uniform Percentage method.

+++++

Case VI

GP grades from .95 to .98 of YRTNP

$$\begin{aligned} \text{UR} &= .97 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{.95}{.97} < 1 \end{aligned}$$

The UNP's are all less than YRTNP's for the first 31 durations, so a retrospective reserve calculation produces negative terminal reserves. Thus, the mean reserve is one half a lower net premium on the Uniform Percentage Method. The UNP's are all greater than YRTNP's for the last 29 durations, so a prospective reserve calculation also produces negative terminal reserves, so the mean reserve is set equal to one half a larger net premium on the Uniform Percentage Method.

Total Reserves are equal on both methods due to Deficiency Reserves.

There are Deficiency Reserves at all durations on both methods, but they are larger on the Uniform Percentage Method.

+++++

Case VII

GP grades from 1.10 to .95 of YRTNP

$$\begin{aligned} &UR = 1.02 \\ &\frac{UNP_1}{YRTNP_1} = \frac{1.10}{1.02} > 1 \end{aligned}$$

Basic Reserves on Uniform Percentage Method are always greater as UNP's are all greater than YRTNP's for the first 31 durations and all less thereafter.

There are no Deficiency Reserves on Uniform Percentage Method, but there are on YRT Method, as YRTNP's produce deficiencies for years 41-60.

Total Reserves were less under the Uniform Percentage Method for seven years and greater thereafter.

+++++

Case VIII

GP grades from .95 to 1.10 of YRTNP

$$\begin{aligned} &UR = 1.03 \\ &\frac{UNP_1}{YRTNP_1} = \frac{.95}{1.03} < 1 \end{aligned}$$

The UNP's are all less than YRTNP's for the first 31 durations, so retrospective reserve calculation produces negative terminal reserves. Thus, the mean reserve is one half a lower net premium on the Uniform Percentage Method. The UNP's are all greater than YRTNP's for the last 29 durations, so a prospective reserve calculation also produces negative terminal reserves, so the mean reserve is set equal to one half a larger net premium on the Uniform Percentage Method.

There are no Deficiency Reserves on Uniform Percentage Method, but there are on YRT Method for 19 years as GP is sufficient thereafter.

Total Reserves were initially smaller on the Uniform Percentage Method but became larger at duration 31 when the Basic Reserve was larger than on the YRT Method and there were no Deficiency Reserves.

+++++

Case IX

GP grades from 1.02 to .98 of YRTNP

$$\begin{aligned} &UR = .98 \\ &\frac{UNP_1}{YRTNP_1} = \frac{1.02}{.98} > 1 \end{aligned}$$

Basic Reserves on Uniform Percentage Method are always greater as UNP's are all greater than YRTNP's for the first 31 durations and all less thereafter.

There are Deficiency Reserves at all durations on the Uniform Percentage Method. Under the YRT Method, there are Deficiency Reserves at all durations, although the YRTNP is less than GP after the first 17 years.

Total Reserves are smaller on the Uniform Percentage Method for 19 years. In that year, GP becomes less than YRTNP and Total Reserves are equal at all remaining durations.

++++++

Case X

GP grades from .95 to 1.02 of YRTNP

$$\begin{aligned} \text{UR} &= .99 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{.95}{.99} < 1 \end{aligned}$$

The UNP's are all less than YRTNP's for the first 31 durations, so a retrospective reserve calculation produces negative terminal reserves. Thus, the mean reserve is one half a lower net premium on the Uniform Percentage Method. The UNP's are all greater than YRTNP's for the last 29 durations, so a prospective reserve calculation also produces negative terminal reserves, so the mean reserve is set equal to one half a larger net premium on the Uniform Percentage Method.

There are Deficiency Reserves at all durations on the Uniform Percentage Method, but only at the earlier durations on the YRT Method as the YRTNP's produce deficiencies only for years 1-43.

Total Reserves on the Uniform Percentage Method are less for all years. GP first exceeds YRTNP in the 44th year. As UNP is deficient, future benefits are being offset with future GP's rather than with lower YRTNP's. Although this should produce smaller Total Reserves under the Uniform Percentage Method, they became larger as Total Reserves were set equal to one half GP.

++++++

Case XI

GP grades from 1.05 to .95 to 1.05 of YRTNP

$$\begin{aligned} \text{UR} &= .99 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{1.05}{.99} > 1 \end{aligned}$$

Basic Reserves on the Uniform Percentage Method are initially greater than on the YRT Method because  $\text{UNP}_1 > \text{YRTNP}_1$ . However, this relationship changes when  $\text{UNP}_t < \text{YRTNP}_t$ , as  $.95 < .99$ . In this example, the Basic Reserves on the Uniform Percentage Method were larger for 30 years, smaller for 11 years and larger for 19 years.

There are Deficiency Reserves at all durations on the Uniform Percentage Method. Under the YRT Method, there are Deficiency Reserves for the first 44 years. The YRTNP's produce deficiencies for durations 16-45.

Total Reserves were always smaller on the Uniform Percentage Method.

++++++

Case XII

GP grades from 1.10 to .95 to 1.10 for YRTNP

$$\begin{aligned} \text{UR} &= 1.006 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{1.10}{1.006} > 1 \end{aligned}$$

Basic Reserves on Uniform Percentage Method are initially greater than on YRT Method because  $\text{UNP}_1 > \text{YRT}_1$ . However, this relationship changes when  $\text{UNP}_t < \text{YRTNP}_t$ , as  $.95 < 1.006$ . In this example, the Basic Reserves on the Uniform Percentage Method were larger for 30 years, smaller for 11 years and larger for 19 years.

There are no Deficiency Reserves on the Uniform Percentage Method. Under the YRT Method, there are Deficiency Reserves for the first 39 years. The YRTNP's produce deficiencies for durations 21-40.

Total Reserves were smaller on the Uniform Percentage Method for the first 41 years and larger thereafter as the Basic Reserves were then larger on the Uniform Percentage Method and there were no Deficiency Reserves.

+++++

Case XIII

GP grades from 1.02 to .98 to 1.30 of YRTNP

$$\begin{aligned} \text{UR} &= 1.05 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{1.02}{1.05} < 1 \end{aligned}$$

The UNP's are all less than YRTNP's for the first 37 durations, so a retrospective reserve calculation produces negative terminal reserves. Thus, the mean reserve is one half a lower net premium on the Uniform Percentage Method. The UNP's are all greater than YRTNP's for the last 33 durations, so a prospective reserve calculation also produces negative terminal reserves, so the mean reserve is set equal to one half a larger net premium on the Uniform Percentage Method.

There are no Deficiency Reserves on the Uniform Percentage Method. Under the YRT Method, there are Deficiency Reserves for the first 31 years. The YRTNP's produce deficiencies at durations 16-32.

Total Reserves equal Basic Reserves.

+++++

Case XIV

GP grades from .98 to 1.02 to .70 of YRTNP

$$\begin{aligned} \text{UR} &= .95 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{.98}{.95} > 1 \end{aligned}$$

Basic Reserves on Uniform Percentage Method are always greater as UNP's are all greater than YRTNP's for the first 37 durations and all less thereafter.

There are Deficiency Reserves at all durations on both methods, although YRTNP's are less than GP's at durations 15-32.

Total Reserves were smaller on the Uniform Percentage Method for 31 years. At the 32nd duration, when GP again became less than YRTNP, Total Reserves on both methods became equal.

+++++

Case XV

GP grades from .95 to 1.02 to .95 of YRTNP

$$\begin{aligned} \text{UR} &= .99 \\ \frac{\text{UNP}_1}{\text{YRTNP}_1} &= \frac{.95}{.99} < 1 \end{aligned}$$

Basic Reserves are negative on the Uniform Percentage Method for the first 19 durations, so the mean reserve is one half a lower net premium on the Uniform Percentage Method. For durations 42-60, UNP's are lower than YRTNP's so mean reserves are larger on the Uniform Percentage Method. For durations 20-41, the fact that UNP's are larger than YRTNP's is offset by the reverse relationship in durations 42-60 and reserves were larger on the Uniform Percentage Method.

There are Deficiency Reserves at all durations on both methods, although YRTNP's are less than GP's at durations 22-39.

Total Reserves were less on the Uniform Percentage Method for 39 years. In the 40th year, when GP again became less than YRTNP, Total Reserves on both methods became equal.

+++++

Case XVI

GP grades from .95 to 1.05 to .95 of YRTNP

$$\begin{aligned} UR &= 1.01 \\ \frac{UNP_1}{YRTNP_1} &= \frac{.95}{1.01} < 1 \end{aligned}$$

Basic Reserves are negative on the Uniform Percentage Method for the first 19 durations, so the mean reserve is one half a lower net premium on the Uniform Percentage Method. For durations 42-60, UNP's are lower than YRTNP's, so mean reserves are larger on the Uniform Percentage Method. For durations 20-41, the fact that UNP's are larger than YRTNP's is offset by the reverse relationship in durations 42-60 and reserves were larger on the Uniform Percentage Method.

There are no Deficiency Reserves on the Uniform Percentage Method. Under the YRT Method, there are Deficiency Reserves at all durations, although YRTNP's are less than GP's at durations 16-45.

Total Reserves were less on the Uniform Percentage Method for 34 years and greater thereafter.

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## ATTACHMENT 3 TO ATTACHMENT C1

Section 4 of the Standard Valuation Law (Attachment A2 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 period of level premium should be a uniform percentage of the gross premiums for that 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 period of level premiums and for each subsequent period separately.

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 the 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 \$1000 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 definition.

**ATTACHMENT 4 TO ATTACHMENT C1**  
**Comparison of Margins at Selected Ages**  
**for 1958 CSO and "Modern CSO" Mortality Tables**

Margin Per 1000

Age	1958 CSO Over		"Modern CSO" Over 1965-70 Experience
	1950-54 Experience	1965-70 Experience	
0	.75	2.85	.75
1	.76	1.02	.76
5	.80	.91	.80
10	.85	.95	.85
15	.90	1.01	.90
20	.95	.99	.95
25	1.00	.93	1.00
30	1.05	1.06	1.05
35	1.10	1.23	1.09
40	1.17	1.53	1.15
45	1.32	2.02	1.27
50	1.61	2.86	1.50
55	2.07	4.03	1.87
60	2.78	6.01	2.46
65	4.14	7.44	3.67
70	6.49	11.73	5.71
75	9.57	14.75	8.79
80	14.34	19.75	13.53
85	21.02	23.93	20.58
90	29.76	30.67	29.62
95	48.21	58.94	46.48

**Comparison of Margins at Selected Ages**  
**for 1958 CSO and "Modern CSO" Mortality Tables**

Ratio of Margin to Experience Rate

Age	1958 CSO to		"Modern CSO" to 1965-70 Experience
	1950-54 Experience	1965-70 Experience	
0	11.8 %	67.4 %	17.7 %
1	76.0	137.8	102.7
5	145.5	206.8	181.8
10	236.1	365.4	326.9
15	160.7	224.4	200.0
20	113.1	123.8	118.8
25	107.5	93.0	100.0
30	97.2	99.1	98.1
35	78.0	96.1	85.2
40	49.6	76.5	57.5
45	32.8	60.7	38.1
50	24.0	52.4	27.5
55	18.9	44.9	20.8
60	15.8	41.9	17.2
65	15.0	30.6	15.1
70	15.0	30.8	15.0
75	15.0	25.2	15.0
80	15.0	21.9	15.0
85	15.0	17.4	15.0
90	15.0	15.5	15.0
95	15.9	20.2	15.9

Comparison of 1000 qx on 1958 CSO, 1950-54 Experience,  
 "Modern CSO" and 1965-70 Experience Mortality Tables

<u>Age</u>	<u>1958 CSO</u>	<u>1950-54 Experience</u>	<u>"Modern CSO"</u>	<u>1965-70 Experience</u>
0	7.08	6.33	4.98	4.23
1	1.76	1.00	1.50	.74
2	1.52	.75	1.44	.67
3	1.46	.68	1.36	.58
4	1.40	.61	1.30	.51
5	1.35	.55	1.24	.44
6	1.30	.49	1.19	.38
7	1.26	.44	1.15	.33
8	1.23	.40	1.12	.29
9	1.21	.37	1.11	.27
10	1.21	.36	1.11	.26
11	1.23	.37	1.12	.26
12	1.26	.39	1.15	.28
13	1.32	.44	1.20	.32
14	1.39	.50	1.27	.38
15	1.46	.56	1.35	.45
16	1.54	.63	1.43	.52
17	1.62	.70	1.51	.59
18	1.69	.76	1.60	.67
19	1.74	.80	1.68	.74
20	1.79	.84	1.75	.80
21	1.83	.87	1.82	.86
22	1.86	.89	1.88	.91
23	1.89	.91	1.93	.95
24	1.91	.92	1.97	.98
25	1.93	.93	2.00	1.00
26	1.96	.95	2.03	1.02
27	1.99	.97	2.06	1.04
28	2.03	1.00	2.08	1.05
29	2.08	1.04	2.10	1.06
30	2.13	1.08	2.12	1.07
31	2.19	1.13	2.15	1.09
32	2.25	1.18	2.19	1.12
33	2.32	1.24	2.23	1.15
34	2.40	1.31	2.29	1.21
35	2.51	1.41	2.37	1.28
36	2.64	1.53	2.47	1.37
37	2.80	1.68	2.59	1.48
38	3.01	1.88	2.75	1.63
39	3.25	2.10	2.94	1.81
40	3.53	2.36	3.15	2.00
41	3.84	2.65	3.39	2.22
42	4.17	2.95	3.65	2.46
43	4.53	3.28	3.94	2.73
44	4.92	3.64	4.26	3.02

<u>Age</u>	<u>1958 CSO</u>	<u>1950-54 Experience</u>	<u>"Modern CSO"</u>	<u>1965-70 Experience</u>
45	5.35	4.03	4.60	3.33
46	5.83	4.46	4.98	3.67
47	6.36	4.94	5.41	4.06
48	6.95	5.47	5.87	4.47
49	7.60	6.06	6.39	4.94
50	8.32	6.71	6.96	5.46
51	9.11	7.42	7.60	6.04
52	9.96	8.19	8.30	6.67
53	10.89	9.03	9.07	7.37
54	11.90	9.94	9.92	8.14
55	13.00	10.93	10.84	8.97
56	14.21	12.02	11.84	9.87
57	15.54	13.22	12.91	10.84
58	17.00	14.54	14.06	11.88
59	18.59	15.98	15.34	13.03
60	20.34	17.56	16.79	14.33
61	22.24	19.26	18.47	15.84
62	24.31	21.10	20.43	17.60
63	26.57	23.09	22.69	19.62
64	29.04	25.25	25.23	21.88
65	31.75	27.61	27.98	24.31
66	34.74	30.21	30.90	26.87
67	38.04	33.08	33.93	29.50
68	41.68	36.24	37.04	32.21
69	45.61	39.66	40.29	35.03
70	49.79	43.30	43.77	38.06
71	54.15	47.09	47.58	41.37
72	58.65	51.00	51.80	45.04
73	63.26	55.01	56.51	49.14
74	68.12	59.23	61.71	53.66
75	73.37	63.80	67.41	58.62
76	79.18	68.85	73.61	64.01
77	85.70	74.52	80.31	69.83
78	93.06	80.92	87.52	76.10
79	101.19	87.99	95.31	82.88
80	109.98	95.64	103.76	90.23
81	119.35	103.78	112.95	98.22
82	129.17	112.32	122.97	106.93
83	139.38	121.20	133.85	116.39
84	150.01	130.45	145.51	126.53
85	161.14	140.12	157.79	137.21
86	172.82	150.27	170.57	148.32
87	185.13	160.98	183.78	159.81
88	198.25	172.39	197.47	171.71
89	212.46	184.75	211.81	184.18

Age	1958 CSO	1950-54 Experience	"Modern CSO"	1965-70 Experience
90	228.14	198.38	227.09	197.47
91	245.77	213.71	243.72	211.93
92	265.93	231.24	262.23	228.03
93	289.30	251.47	283.27	246.32
94	316.66	274.90	307.61	267.02
95	351.24	303.03	338.78	292.30
96	400.56	343.36	384.83	329.76
97	488.42	409.79	469.93	394.24
98	668.15	522.62	648.88	507.73
99	1,000.00	708.55	1,000.00	699.23
100	--	1,000.00	--	1,000.00

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

(C3) Life Insurance

June 1978

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This report concerns only the proceedings of the NAIC Technical Task Force to Review Valuation and Nonforfeiture Value Regulation since the December 1977 meeting. Recommendations for approval of four guidelines to be sent to the Financial Condition Examination (A5) Subcommittee for consideration for inclusion in the Financial Condition Examiners Handbook were made in a Special Report, dated May 1978, sent to all members of the NAIC.

A. Proceedings of the Task Force

This report includes the minutes of two meetings, December 4, 1977 (Attachment A) and April 7, 1978 (Attachment B), a draft of four guidelines prepared March 13, 1978 by the American Council of Life Insurance (Attachment C, some of which is omitted here since the first three guidelines recommended were incorporated into those proposed and adopted in the May 1978 Special Report), a draft of 16 guidelines prepared by the California Insurance Department January 6, 1978 (Attachment D). Also attached are two items with respect to Deposit Term Insurance (Attachments E1 and E2) and two other items on other subjects (Attachments F and G). Attachment H presents a draft of proposed revisions to the NAIC Model Variable Annuity Regulation to accommodate the NAIC Model Individual Deferred Annuity Nonforfeiture Law.

1. Actuarial Guidelines

- a. Four guidelines are recommended at this time (see Special Report dated May 1978).
- b. Deposit Term Insurance (see Attachments C (item 1e), E1 and E2). The principal problems in drafting this guideline are:

- (1) The question of whether such a guideline, with respect to minimum nonforfeiture values, can be supported by the present nonforfeiture law or whether a revision of the law is needed. If the law is changed, there may not be a need for a guideline with respect to minimum nonforfeiture values.
  - (2) The form of disclosure requirements. One insurer has admitted that 44% of its deposit term business was through replacements. Discussed by the task force was the concept that the full dollar amount of commissions or allowances to agents should be disclosed. A counter argument to this concept was that such disclosure is not now required of vendors of other products (automobiles, clothing, etc.). Sales commission disclosure is required, however, in most jurisdictions with respect to real estate sales handled through escrow and with respect to the sales of securities.
  - (3) The concept that the nonforfeiture values should present "a reasonable progression of cash values."
- c. Other Guidelines. Attachment D is a draft for the purpose of discussion of some other guidelines which might be feasible.
2. Progress on Revision of the Standard Nonforfeiture Law. No further progress can be made until the new mortality tables become available. A brief note from E. J. Moorhead (Attachment D) expresses interest in this area.
3. Progress on the Construction of a New Mortality Table. Principal features of the present status in the construction of a new mortality table are:
- a. The testing of possible basic tables:
    - (1) There is a marked hump in male mortality at age 15 through 24 due to the high incidence of deaths by accident at these ages. Female mortality does not show such a tendency.
    - (2) The effect on policy reserves for various combinations of plans, ages at issue and combinations of sexes must be studied to determine if any simplified rules or tables can be used to avoid such a multiplicity of factors. The male mortality both with the hump and with the hump smoothed out must be considered.
  - b. Margins or Loadings. Appropriate loadings must be developed to add to the basic table with such considerations as:
    - (1) Reinsurance makes it difficult to make a meaningful analysis of the effect of a new table on smaller companies.
    - (2) Perhaps a statistical approach (such as using a Monte Carlo technique) would be more appropriate than contribution of data from smaller companies which could have questionable credibility.
    - (3) Starting with margins using both the 1958 CSO and 1941 CSO methods, for the 1941 CSO method an annuity expectation at 4% interest could be used rather than a life expectation (annuity at 0% interest) and a factor of 2½% and 5% of the reciprocal of the annuity expectation.
  - c. Technical Assumptions.
    - (1) Experience Period. 1970 to 1975 anniversaries.
    - (2) Select and Ultimate. An table should be developed (policy years six and over) with an appendage which could be used as an option for the first five policy years. The task force has discussed the possibility that the table should be first developed as a five-year select and ultimate table and that reserve structures should then be tested for various combinations of plans, age and sex, and type of tables (select and ultimate v. ultimate only).
    - (3) Terminal Age. The possibilities of extending the tables beyond age 100 should be contemplated. This is particularly true for female mortality and to a lesser degree for male mortality.

4. **Variable Annuity Nonforfeiture Value Regulation.** This material, formerly considered by a separate NAIC subcommittee, now comes under the charges of the Life Insurance (C3) Subcommittee. Attachment H is a draft of the changes to the NAIC Model Variable Annuity Regulation to accommodate the NAIC Model Individual Deferred Annuity Nonforfeiture Law.

#### B. Recommendations

See Special Report dated May 1977 for recommendations.

John O. Montgomery, Chairman, California; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; Thomas J. Kelly, New York; Robert A. Dolan, Pennsylvania; Ted Becker, Texas; Bradford S. Gile, Wisconsin.

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### ATTACHMENT A

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

#### (C3) Life Insurance

Miami, Florida  
December 4, 1977

The NAIC (C) Committee Technical Task Force to Review Valuation and Nonforfeiture Value Regulation met from 9:00 a.m. until 6:00 p.m. on December 4, 1977 in the Cavalier 2 Room of the Deauville Hotel, Miami, Florida.

Present at the meeting were: for the NAIC technical task force: John O. Montgomery, Chairman, California; James R. Montgomery III, District of Columbia; Larry M. Gorski, Illinois; Erma Edwards, Nevada; Marvin E. VanCleave, Wisconsin.

Representing the technical advisory committees to the NAIC task force were: E. Paul Barnhart, Consultant (Accident & Health (C1) Technical Advisory Committee); William C. Cutlip, CUNA Mutual and Charles Underwood, Maryland Life (Credit Insurance (C2) Technical Advisory Committee); Bruce Nickerson, ACLI, (Variable Products (C4) Technical Advisory Committee).

Representing the Society of Actuaries Special Committee on Nonforfeiture Value Regulation was Charles Greeley, Metropolitan Life Insurance Company.

Representing the consumer advisory committee to the NAIC technical task force were: Eleanor J. Lewis, New Jersey Insurance Department; Marcia Greenberger, Center for Law and Social Policy; Robert Sable and Willard Ogburn, National Consumer Law Center, Inc.

Representing the American Council of Life Insurance were: Richard V. Minck; John K. Booth; Vincent W. Donnelly.

Representing the Health Insurance Association of America was David Robbins.

Other persons present at the meeting were: Ken Jones, CUNA Mutual; Gregg Carney, Anchor National Life Insurance Company; David Holland, Munich American Reassurance Company; Jack Richardson, Missouri Insurance Division; Gerald H. Pugh, Combined Insurance Company of America; Perry Kupferman, Provident Alliance Life Insurance Company; Mike Medland, CUNA Mutual; Norris Robinson, Merit Life Insurance Company; J. H. Hunt, Massachusetts Insurance Department; Larry Gilbertson, Aetna Variable Annuity Life Insurance Company; Jay Koleski, Minnesota Insurance Division; Jim Blazek, Maryland Life Insurance Company; Doug Broome, South Carolina.

#### Consumer Advisory Committee Input

Eleanor Lewis, temporary chairperson, submitted a written report concerning the committee's attendance at the technical task force meeting in Boston on October 22-23, 1977. In essence, her report expressed the following:

- (1) The availability of funds to pay for consumers to attend committee meetings is an issue which must be answered.
- (2) The Society of Actuaries should prepare tables detailing male lives, female lives and male and female lives combined in each situation where a table is prepared.
- (3) Persons from the insurance industry should not be included in the membership of a consumer committee.
- (4) Five specific recommendations were made to Paul Barnhart, Chairman of the Accident & Health Valuation Technical Advisory Committee, which the committee felt should be considered in developing tables for loss-of-time disability benefits so as to make them more reflective of future developments as regards female purchasers of policies.

A written report concerning the constitution and funding of the consumer advisory committee (dated December 4, 1977) was submitted to the technical task force by Marsha Greenberger and Robert Sable. Recommendations contained in this report were as follows:

- (1) Consumer participation should be directed, for the time being, to credit and sex discrimination issues as a general matter.
- (2) The consumer advisory committee should also work with other task forces, such as Sex Discrimination and Long Term Credit, and with the relevant committees and subcommittees.
- (3) Membership of the consumer committees should be limited to individuals who are consumer advocates in the two committee areas - credit and sex discrimination - and should be divided into two separate subcommittees representing these specific areas.
- (4) The NAIC should explore possible means of providing funds to these subcommittees. An annual budget of \$11,400 was included.

Ms. Marsha Greenberger agreed to serve as coordinator of the consumer advisory committee's activities due to the departure of Dr. Eleanor Lewis as temporary chairperson.

#### For the Life Insurance (C3) Subcommittee

The first item on the agenda was a discussion of the (C) Committee Technical Task Force to be presented to the Life Insurance (C3) Subcommittee covering the proceedings of the task force since the June 1977 meeting. It was pointed out that an item requiring a decision of the NAIC at the December 1977 meeting was sent in a "Special Report" dated November 4, 1977 to all members of the NAIC. This item is a recommended modification to the 1958 Commissioners Standard Ordinary Mortality Table and the 1958 CET Table to provide for the six-year age setback for females at ages under 20. There were no comments regarding the text of the report, however, various attachments to the report were discussed at length.

A correction was made in the draft of the guidelines for valuation with respect to interest rate guarantees on active life funds held relative to group annuity contracts. It was pointed out that this guideline should be flexible so that the Examiners Handbook will not have to be updated each year, i.e. the table could be made a separate part of the guidelines and updated in a manner similar to the Securities Valuation Manual. This guideline will be prepared in final form for adoption in June.

There were no comments concerning Howard Kayton's recommendation on the Standard Nonforfeiture Law for Individual Deferred Annuities.

There was a discussion concerning the relative merits of the Texas Directive Regarding the Valuation of Renewal Term Plans as compared with the American Council of Life Insurance version. It was pointed out that the Texas Directive applies to existing contracts whereas the ACLI version provides for a grading procedure for existing contracts. The ACLI five-year grading provision was discussed, however, it was determined that it should be left unchanged. It was felt the Texas Directive leaves several loopholes which are covered by the ACLI version. In this connection reference was made to the fact that Texas is currently in the process of amending its regulation. The Texas version applies only to ultimate status whereas the ACLI draft applies to both select and ultimate. The ACLI version recommends the Modern CSO throughout whereas the Texas version leaves the mortality table in somewhat of a state of flux.

John Booth of the ACLI asked that his letter of May 25, 1977 be made a part of the report together with his October 6, 1977 letter. John's letter was included as Attachment C4(a). John stated that the ACLI Model Directive attached to the proposed draft of the report to the (C3) Subcommittee was just about in a form ready for adoption. A discussion ensued as to whether this should be in the form of a directive or incorporated as a guideline in the Examiners Handbook. It was decided that it should be put in the handbook along with a statement to the effect that any state wishing to adopt the guideline should first promulgate an appropriate directive or regulation.

Attachment C5 to the draft of the report consisted of excerpts from proposed revisions in the NAIC Standard Nonforfeiture Law for Life Insurance which apply to deposit term insurance. It was determined that there is an immediate need to deal with this problem by means of a guideline which would serve as an aid in applying existing statutes dealing with misrepresentation or unfair trade practices rather than attacking the problem through existing nonforfeiture laws. John Booth agreed to prepare a draft of such a guideline by the next meeting.

Bradford Gile is currently working on a proposed guideline for the purpose of assisting regulators in differentiating between life insurance and annuities. This is necessary in making a determination as to which of the nonforfeiture laws (life insurance or annuity) applies to certain specific products. The problem was originally discussed in Mr. Gile's letter of October 10, 1977.

It was reiterated that no further action by the task force is possible with respect to a revision of the Standard Nonforfeiture Law until a new mortality table is developed. However, there was a discussion regarding sections 6 and 7 of the October 6, 1977 ACLI draft of Proposed Revisions to the NAIC Standard Nonforfeiture Law for Life Insurance. The ACLI expressed its feeling as to the necessity for the flexibility which section 6 would give to the regulator with respect to those kinds of life insurance policies not contemplated by the law. The task force expressed its disagreement with the ACLI position concerning this point, and Chairman John Montgomery stated that, in his view, the issue involving section 6 is important enough that this section should be proposed separately when the task force finally presents a new nonforfeiture law for adoption. As regards section 7, it was suggested by the task force Chairman that the language of that section should be reviewed in order to see if it could be made clearer so as to insure that the intended objective is accomplished. John Booth agreed to redraft section 7 with this purpose in mind.

There was a brief discussion relative to particular problem plans including split life, the retired life reserve plan (which John Montgomery agreed to mail out material on) and joint whole life policies with benefits payable upon the second death.

There was also a brief discussion of the problem of constructing joint life values under the new mortality table where there will be separate tables for male and female lives.

For the Variable Life and Variable Annuity (C4) Subcommittee (now part of the (C3) Subcommittee)

There were no comments or discussion regarding the technical task force's draft report to be presented to the Variable Life Insurance and Variable Annuity (C4) Subcommittee. There was, however, a discussion of a specific life insurance-policy which the task force had referred to the industry advisory committee for their review. Bruce Nickerson of the ACLI expressed the industry advisory committee's view that the contract, which provided benefits based upon the New York Stock Exchange Index, would definitely require additional reserves although it would be difficult, if not impossible, to determine the magnitude of the additional reserve. It was agreed that this type of contract is not within the purview of the Variable Products Technical Advisory Committee.

John O. Montgomery, Chairman, California; James Montgomery III, District of Columbia; Larry Gorski, Illinois; Erma Edwards, Nevada; Thomas J. Kelly, New York; Robert A. Dolan, Pennsylvania; Ted Becker, Texas; Bradford S. Gile, Wisconsin.

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## ATTACHMENT B

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

## (C3) Life Insurance

Tampa, Florida  
April 6-7, 1978

The NAIC (C) Committee Technical Task Force to Review Valuation and Nonforfeiture Value Regulation met from 9:00 a.m. to 6:00 p.m. on April 6, 1978 and from 9:00 a.m. to 3:30 p.m. on April 7, 1978 in the Ballroom of the Riverside Hilton Hotel, Tampa, Florida.

The following task force members were present: John O. Montgomery, Chairman, California; Larry Gorski, Illinois; William A. White, New Jersey; Thomas J. Kelly, New York; Robert Dolan, Pennsylvania; Ted Becker, Texas; Bradford S. Gile, Wisconsin.

Other state Insurance Department representatives present were: Doug Broome, South Carolina (April 6); Jay Koleski, Minnesota; J. H. Hunt, Massachusetts (April 6); George McDonald, Florida (April 7); L. S. Norman, Indiana.

The Valuation Technical Advisory Committee for Matters Concerning the NAIC Accident and Health (C1) Subcommittee was represented by: Michael Kazakoff, Mutual of Omaha (April 6); Peter Thexton, Health Insurance Association of America (April 6).

The Technical Advisory Committee for Matters Concerning the NAIC Credit Insurance (C2) Subcommittee was represented by: Harvey S. Galloway Jr., Nationwide (April 6); Charles M. Underwood II, Maryland Life (April 6).

The following persons were also present: Jim Allen, Kemper (April 7); Jim Blazek, Maryland Life (April 6); John K. Booth, American Council of Life Insurance (April 7); Will Burgess, Bankers Life & Casualty; Steve Cooper, Security Benefit Life (April 7); Grace V. Dillingham, American Council of Life Insurance; Vincent W. Donnelly, American Council of Life Insurance (April 6); George Harding, University Life (April 7); Robert Hill, Aetna Life & Casualty (April 7); David Holland, Munich American Reassurance (April 7); Ken Jones, CUNA Mutual (April 6); Spencer Koppel, Combined Insurance; Harold Leff, Metropolitan Life (April 7); Mike Medland, CUNA Mutual (April 6); R. A. Miller III, Aetna Life & Casualty (April 7); Richard V. Minck, American Council of Life Insurance (April 7); J. Paul Quinn, TIAA (April 7); Charles F. B. Richardson (April 7); W. Keith Sloan, Kemper; Richard M. Stenson, Equitable, New York (April 7); Phillip Sliwiak, Kemper (April 7); Tom Walsh, TIAA (April 7).

1A. Valuation of Group Annuity Deposit Administration Funds

The task force reviewed the March 6, 1978 draft, "Reserve Requirements for the December 31, Y Valuation With Respect to Interest Rate Guarantees on Active Life Funds Held Relative to Group Annuity Contracts." It noted that the proposal was based on requirements already in effect in New York. The New York Insurance Department publishes a letter each year announcing the maximum interest rate which can be used in valuing funds received in that year. The rate is determined from reports, submitted by companies doing business in New York, of new money rates in the previous year.

The recommendation was being considered by the task force as an actuarial guideline to provide a uniform percentage for all states to use in valuing group annuity deposit administration funds. Promulgation of the maximum interest rate for the funds of each new year could be made through the NAIC Central Office. Mr. Kelly said that the interest rate would be available to the task force each summer for forwarding with its recommendation to the Central Office. It was noted that the companies contributing to the New York rate survey included all the major group annuity writers which would be affected.

The task force decided that there was no need for its proposed recommendation to include instructions for all the years covered by the New York regulation. It then approved the proposal with modifications to provide for release of the maximum interest rate each year by the NAIC Central Office and to include detailed instructions for funds received in 1976 or later.

### 1B. Terminally Loaded Individual Deferred Annuities

The task force reviewed the March 6, 1978 draft of a "Proposed Recommendation on the Standard Nonforfeiture Law for Individual Deferred Annuities." A number of suggestions were made for simplifying the proposal. It was noted that the recommendation clarifies the intention of the NAIC Model Nonforfeiture Law for Individual Deferred Annuities and is not needed in those states where the model has not yet been adopted.

### 1C. Valuation of Renewable Term Plans

The task force reviewed the March 6, 1978 draft, "Proposed Model Directive Regarding Minimum Reserves for Certain Forms of Term Life Insurance." It agreed that the document should be called an "Actuarial Interpretation" rather than a Directive; that it should apply only to plans valued on the 1958 CSO Mortality Table for the current term period; that the mortality basis for determining additional reserves for premium rate guarantees beyond the current term period should be that contained in the December 1977 modification of the Texas Insurance Department Directive Regarding Minimum Reserves for Certain Forms of Term Life Insurance (i.e. a combination of the 1958 CSO Mortality Table and a "Modern CSO" Mortality Table developed for testing purposes by the Society of Actuaries Special Committee on Valuation and Nonforfeiture Laws); that a ceding company's credit for deficiency and additional reserves established by a reinsurer be allowed only against its deficiency and additional reserves for the business reinsured; and that no effective date was needed.

### 1D. Valuation of Policies Whose Valuation Net Premiums Exceed the Annual Gross Premium Charged

It was determined that no action on this subject was needed beyond that taken at the December meeting of the task force.

### 1E. Deposit Term Insurance

The March 7, 1978 draft, "Guidelines for Approval of Deposit-Term-Type Insurance," was discussed at length. Mr. Harding stated that the proposal was inappropriate, since the definition of minimum cash values should be a matter of law. He added that the proposal was premature and reflected a lack of understanding of what deposit term is intended to do. He felt the proposal had been developed without opportunity for comment from those most affected; that it was inequitable, in that the required cash values would exceed asset shares; and that it was unfair because it would require an increase in gross premiums. Asked how much commission is paid on this type of policy, he said it ranged from 150% to 225% of the renewal premium but was no higher in dollars than for the typical ordinary life product.

Mr. Sliwiak and Mr. Holland asked why deposit-term-type contracts should be singled out for special attention, saying they should be subject to the same disclosure and nonforfeiture requirements as any other product.

Mr. Booth and Mr. Minck described the process by which the ACLI had developed a position recommending the adoption of a regulation requiring adequate disclosure together with a regulation clarifying the application of the Standard Nonforfeiture Law to deposit term insurance policies and other related policies. The ACLI proposal would follow the general principles outlined by the Society of Actuaries Committee on Nonforfeiture Benefits in their report, but would establish somewhat lower minimum values. They added that the policy had been approved by the ACLI Board of Directors and various senior committees and had been widely publicized in the process.

Mr. Becker mentioned the Texas requirement for a reasonable progression of cash values. He raised the question of statutory authority for the ACLI proposal.

Mr. Montgomery suggested that the disclosure requirement follow the NAIC Model Solicitation Regulation, with additional requirements. The task force agreed to this approach. After further discussion of the nonforfeiture requirements, the task force decided to continue its consideration of the matter at its next meeting.

## 2. Other Guidelines for Life Insurance and Annuities

The proposed "Interpretation of the California Code: Actuarial Procedures," distributed with the agenda, was briefly discussed. Suggestions were made for clarifying and improving several of the items. It was noted that the proposed "Interpretation" was intended as a compilation of previous rulings in California and that some of the items would be subject to change as guidelines, and interpretations approved by the task force were adopted.

### 3. Construction of a New Mortality Table

Mr. White reported that he had attended a meeting of the Society of Actuaries Special Committee to Recommend New Mortality Tables for Valuation the previous week. Three sets of tables -- male with dip at ages 21-36, male without dip and female -- had been prepared, based on experience of insured lives at durations six and higher between 1970 and 1975 anniversaries. It had been expected that the male mortality dip at the young adult ages would be smoothed out, as in previous valuation tables, but since the dip seems to be becoming more pronounced, the Society Committee wanted the opinion of the task force as to whether this phenomenon should be removed by graduation. It also wanted the opinion of the task force on whether to terminate the tables at age 100, as in the 1941 and 1958 CSO tables, or to extend them to higher ages. The most likely margin would be a function of the reciprocal of the expectation of life, thus, providing higher margins at the higher ages. Mr. White further reported that the interest rate used would have more impact on reserves than would the use of a select and ultimate mortality table rather than simply an ultimate mortality table. Monte-carlo techniques had been used to test the adequacy of reserves in the event of substantial mortality fluctuations. Mortality assumptions for extended term insurance and the method for combining male and female tables were still to be considered.

The task force discussed reasons for and against preserving the mortality dip. It concluded that it could not make a decision without more information about the impact on reserves and cash values of the dip and asked that the Society Committee have the necessary comparisons prepared. It also asked the Society Committee to test the effects of extending the tables to age 105 for men and 110 for women. It asked the committee to test the effects of using select and ultimate tables. It asked the committee to investigate the effect of various extended term mortality assumptions and to demonstrate the effect on reserves of using unisex tables with different proportions of male and female lives (10-90, 50-50, 90-10).

The task force agreed to ask the Society Committee to prepare a complete set of mortality tables, including select and ultimate, with and without margins, and some appropriate financial functions, by the time of the task force meetings to be held in conjunction with the Annual Meeting of the Society of Actuaries in October. Preliminary figures were to be requested for the next task force meeting, to be held in conjunction with the June meeting of the NAIC, so that decisions necessary to the progress of the committee's work could be made in June.

### 4. Revision of the Standard Nonforfeiture Law

The task force reviewed the proposed revision in the first two sentences of section 7 of the NAIC Standard Nonforfeiture Law, attached to Mr. Booth's letter of March 13, 1978. It agreed to accept the proposal that calculation of minimum values on the assumption that premiums are paid continuously be allowed as an alternative to the use of curtable functions. It did not accept the alternatives regarding the assumptions as to the time of payment benefits and the basis for determining the age of the insured.

### 5. Nonforfeiture Requirements for Variable Annuities

Mr. Leff told the task force that the Standard Nonforfeiture Law for Individual Deferred Annuities does not allow enough expense allowance for variable annuities. It is close to what is currently needed and makes no provision for future inflation. (The corresponding problem does not exist in fixed annuities because of available margins in the interest assumptions.) He also thought a charge should be allowed on each transaction such as transfers between fixed and variable accumulation accounts, not just on the payment of considerations. Finally, he thought that the insurance company's right to cash out small contracts should depend on the current contract value rather than on total prior contributions, since the insured may have already reduced the contract value through substantial partial withdrawals. Mr. Montgomery suggested that Mr. Leff participate in the work of the industry advisory committee which is developing nonforfeiture requirements for variable annuities.

### 6. Other Matters

There was a brief discussion of the possibility of defining interest rates in the valuation and nonforfeiture laws in terms of a readily available measure of current market rates rather than in terms of a specific rate which can quickly become out of date. It was noted that a subcommittee of the American Council of Life Insurance is exploring the possibility.

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## ATTACHMENT C

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

From: John K. Booth  
Associate Actuary  
American Council of Life Insurance  
1850 K Street, N.W.  
Washington, D. C. 20006

Date: March 13, 1978

Re: Group Annuity Deposit Administration Funds

Enclosed are proposals or revisions of prior proposals relating to the following:

1. Actuarial Guidelines on Valuation of Renewable Term Plans

On October 6, 1977, we mailed to you a revision of an earlier May 25, 1977 draft of a "Proposed Model Directive Regarding Minimum Reserves for Certain Forms of Term Life Insurance." Since that time we have discovered a major loophole, both in our proposal and in the Texas Directive, which was considered at your meeting on October 22. The loophole is created by the implicit assumption in both directives that renewable term insurance will be issued in the form of a series of successive term policies up to a state age. Therefore, both directives fail to make provision for term insurance issued for one continuous term to a state age or to the end of life with increasing premiums.

As an example, if a company were to issue level term insurance to age 99 where premiums increase each year, are approximately equal to premiums under an annual renewable term policy and differ by one penny at each renewal age from the premium at that attained age for a new issue, such a policy would be excluded from the scope of the Texas Directive and subject to deficiency reserve requirements based on the 1958 CSO Mortality Table. However, since there is one continuous term period, the application of the Commissioners Reserve Valuation Method with a net premium at all durations equal to a uniform percentage of the gross premium would enable companies to avoid having to establish any deficiency reserves by setting artificially high premiums at older ages. Earlier drafts of the proposed model directive avoided this problem by eliminating the attained age test but left part of the loophole open by referring to multiple term periods. This latter problem could be solved by limiting the application of the uniform-percentage-of-gross rule to the successive periods of level premiums, where a period of level premiums could be as short as one year, rather than limiting it to successive term periods, which is the language used both in our proposal and in the Texas Directive.

The specific changes in the proposed model are:

- (1) The addition of the words, "or term to a stated age with generally increasing premiums" in the second line of the second paragraph under Scope.
- (2) The modification of the first sentence of the paragraph beginning on page 3 to read as follows:

The other approach is to hold policy reserves for only the current period of years (not necessarily equal to the renewal period) during which the required premium per \$1000 remains level [only], including deficiency reserves if appropriate, and to establish additional] Additional reserves are established where net premiums, calculated on a basis which reflects current mortality, exceed gross premiums for future [term] periods of level premiums.

- (3) A change in the terminology on the first sentence of page 4 to refer to, "separating successive periods of level premiums," instead of "separating the term periods."
- (4) A change on page 4 in the first paragraph and in the indented paragraph to substitute a reference to "period of level premiums" for the words "term period."
- (5) The deletion in the indented paragraph on page 4 of the word "renewable" before the words "gross premiums" and the deletion in the paragraph starting on page 5 under Adequacy of Reserves of the word "renewable" before the words "term contracts."

In accordance with the agreement of your task force at the October 22 meeting, the last paragraph formerly on page 4 relating to a five-year grade-in period to the new standards has been deleted.

## 2. Actuarial Guidelines on Deposit Term Insurance

Although deposit-term-type products have a place in the spectrum of life insurance products that are offered to fulfill specific public needs, the nature of these products is such as to easily lead to possible misunderstanding unless the coverage is fully and properly explained. It is also possible to design deposit-term-type products which cause losses to policyholders lapsing before the end of the deposit period of the sort that the Standard Nonforfeiture Law was intended to preclude.

Because of these potential deficiencies, the Council has adopted a policy of supporting within the NAIC and in the various states generalized disclosure requirements with respect to deposit-term-type insurance similar to those contained in a Washington Insurance Department bulletin of September 19, 1977. The Council also supports minimum nonforfeiture requirements for deposit term insurance derived from the principles contained in the proposed revisions of the NAIC Standard Nonforfeiture Law for Life Insurance. In the case of deposit whole life insurance sometimes referred to as modified premium whole life insurance, the Council recommends determining minimum nonforfeiture requirements by applying the Standard Nonforfeiture Law separately to the term coverage period and the whole life coverage period irrespective of any language in the policy which states that the conversion to whole life is automatic or that the coverage period is continuous. This follows the suggestion of the Society of Actuaries Special Committee on Valuation and Nonforfeiture Laws that minimum nonforfeiture values should be based on the nature of the underlying coverage even though it may be called by a different name. These recommendations of the Council are included in the enclosed draft of "Guidelines for Approval of Deposit-Term-Type Insurance" which is intended to eliminate potential deficiencies in the sale of these kinds of products.

## 3. Revision of the Standard Nonforfeiture Law

Section 7 of the draft of Proposed Revisions in the Standard Nonforfeiture Law which was submitted to you on October 6, 1977 was intended to give both insurers and regulators the flexibility to calculate and approve minimum nonforfeiture values which, because of technical differences in calculation procedures such as the use of curtate or continuous functions, age next or last birthday rating or different assumptions as to when in the policy year death benefits are payable, differ by trivial amounts from those currently stipulated in the law. Since there has been some confusion as to the meaning and effect of the language included in the October drafts, the Council recommends the substitution of the attached "Proposed Revisions in the First Two Sentences of Section 7 of the NAIC Standard Nonforfeiture Law." This should make it clear that minimum nonforfeiture values may be calculated either according to the method and assumptions described in the first sentence or according to certain alternative specified methods and assumptions which cause only trivial differences in minimum nonforfeiture benefits.

### Guidelines for Approval of Deposit-Term-Type Insurance

March 1978 Draft

#### Scope

These guidelines deal with those annual premium individual insurance products which require the payment of an additional premium in the first contract year, sometimes described as a "deposit." Deposit term insurance, deposit whole life insurance and modified premium whole life insurance are names which are typically given to these products, but these guidelines apply to all products of the type described irrespective of the name given to the coverage.

#### Description of Deposit-Term-Type Products

Deposit term insurance generally involves the payment of an additional first-year premium often characterized as an initial "deposit" which is returned to the policyholder at the end of a selected period of years, usually eight or ten, increased by what is often alleged to be interest but is, in reality, both interest and the forfeitures of those who terminate their contracts during the deposit period.

Deposit whole life or modified premium whole life is similar, except that the term insurance benefit is automatically converted to a whole life plan at attained age in lieu of payment of the increased "deposit" in cash. After the conversion, the nonforfeiture values of the whole life policy may or may not be augmented by the value of the deposit. Some converted policies provide nonforfeiture values which progress so that the deposit gradually disappears over the life of the

policy. Deposit whole life policies generally offer the policyholder the option to “roll over” the deposit and start a new deposit whole life policy instead of continuing on the original contract. In this case the augmented deposit from the original coverage is used as the initial deposit for the new coverage. Thus, it is possible for a deposit whole life insurance policy to be rolled over several times so that it, in effect, becomes a series of renewable deposit term insurance coverages.

The nature of deposit-term-type products is such as to present possibilities of misunderstanding unless such products are carefully sold and fully explained. Certain deposit-term-type products may provide nonforfeiture benefits which are inherently unfair when considered in light of the spirit and intent of Standard Nonforfeiture Law. For these reasons, these guidelines set forth minimum disclosure and nonforfeiture requirements for deposit-term-type products.

#### Minimum Disclosure Requirements for Deposit-Term-Type Products

1. All advertisements, sales materials and sales presentations of deposit-term-type products which fail to fully and fairly inform an applicant or prospective insured as to future premium changes, benefits and related options constitute a misrepresentation as to material facts.
2. In addition, in every case, full information relative to the initial deposit shall be given in writing to the applicant or prospective insured, which shall adequately disclose its amount, forfeiture details, guaranteed values and ultimate disposition under each future required to be disclosed in 1.
3. If the policy contains a provision permitting the making of voluntary additional deposits which will accumulate at interest, the nature thereof shall be disclosed, and such disclosure shall distinguish such deposit provision and the insured's rights thereunder from the initial built-in deposit. It is strongly suggested that the term “deposit” not be used in referring to the additional first-year premium.
4. It is recommended that an “explanation” sheet be given to every applicant or prospective insured with pertinent figures inserted for the specific case showing the amount of premium required for a particular mode of payment, the amount the premium becomes at the end of the deposit term, the amount of the initial built-in deposit, how and when it may be forfeited, its guaranteed nonforfeiture values and its ultimate disposition. Various options should be explained, with premium rates shown. The explanation sheet should set forth a reasonably complete picture of the plan. It would be advisable to have the applicant acknowledge receipt of the explanation sheet on a copy which would be kept by the insurer or its agent.
5. In the case of replacement situations, the required replacement disclosure statement must be filled out so that premium changes and/or options at the end of the deposit term are fully and fairly disclosed to the applicant. This may be done on the replacement disclosure statement itself, in the “premiums” section, for example, or may be shown on a supplemental section attached to the statement.
6. It is the responsibility of the insurance company to see that the public is given a true and complete disclosure of deposit-term-type plans in clear and unambiguous terms. Each company should examine its own particular products to determine how it can most effectively meet its responsibility.

#### Minimum Nonforfeiture Requirements for Deposit-Term-Type Products

The intent of the Standard Nonforfeiture Law is to prevent unjustified forfeitures by terminating policyholders of their equities in their policies. The law fixes a minimum floor for nonforfeiture values on the basis of a rough approximation of their equity in the contract which was defined as follows by the NAIC Committee to Study Nonforfeiture Benefits and Related Matters:

Nonforfeiture benefits may be said to be equitable when they are established at such a level that the withdrawing policyholder will receive a benefit, be it cash or some form of continuing paid-up insurance, which will be as nearly as possible equivalent to his contribution to the funds of the company less the cost of the protection which he received and less the cost of introducing and maintaining him as a policyholder and which will not exceed the largest amount which can be paid to him without impairing the equities of the remaining policyholders of the company. (Reports and Statements on Nonforfeiture Benefits and Related Matters, Actuarial Society of America and American Institute of Actuaries, 1942, p. 58.)

The intent of the law, as stated above, is that the excess initial expense allowance used to define minimum nonforfeiture values for deposit term insurance shall not be based upon the additional premium in the first policy year, since an increase in the first-year premium does not, in itself, increase the cost of protection or the cost of introducing or maintaining the insured as a policyholder. Therefore, nonforfeiture values under deposit term policies shall be at least as great as those calculated by applying the Standard Nonforfeiture Law to the policy but substituting a net level annual premium in place of the adjusted premium for the first policy year in the determination of the excess initial expense allowance. Such a net level annual premium shall be equal to the present value, at the date of issue of the policy, of the sum of the guaranteed term insurance benefits provided for by the policy up to the end of the term period plus the pure endowment benefit provided for by the policy at the end of the term period divided by the present value, at the date of issue of the policy, of an annuity of one per annum payable on the date of issue of the policy and on each anniversary of the policy on which a premium falls due up to the end of the term period.

In the case of deposit whole life insurance or modified premium life insurance which is essentially term insurance followed by permanent, minimum nonforfeiture value requirements shall be determined by applying the Standard Nonforfeiture Law separately to the term coverage period and the whole life coverage period, irrespective of any language in the policy which states that the conversion to whole life coverage is automatic or that the coverage period is continuous. If a pure endowment is not paid out in cash to the policyholder upon conversion to whole life insurance, minimum nonforfeiture values for the whole life insurance policy shall be not less than those computed under the Standard Nonforfeiture Law for the whole life insurance coverage plus the value of the pure endowment benefit accumulated at a rate of interest specified in the policy for accumulating that benefit.

In the case of deposit-term-type products which differ from those described above, the procedures for determining minimum nonforfeiture requirements under this guideline shall be appropriately modified to preserve the intent of the Standard Nonforfeiture Law.

In no event shall the calculation procedures set forth in these guidelines be construed as permitting any nonforfeiture value lower than those which would otherwise be required in the absence of these guidelines.

Examples of minimum nonforfeiture values required by this guideline follow.

Examples of Minimum Nonforfeiture Values  
Required Under the Guidelines for Approval  
of Deposit-Term-Type Products  
Deposit Term -- Eight Year Renewable and Convertible Term

	<u>1958 CSO - 4% Curtate</u> <u>Issue Age 35</u>		
	<u>Case I</u>	<u>Case II</u>	<u>Case III</u>
Term Insurance Benefit	\$1,015.00	\$1,030.00	\$1,100.00
Pure Endowment at End of Term	15.00	30.00	100.00
Annual Level Gross Premium	4.49	4.56	4.87
Additional First Year Premium (Deposit)	7.50	15.00	50.00
Net Level Annual Premium	4.63	6.22	13.61
First-Year Adjusted Premium	17.20	28.43	82.05
Renewal Adjusted Premium	6.44	6.63	7.28
<u>Duration</u>	<u>Minimum Nonforfeiture Values</u>		
0	-23.82	-24.68	-30.83
1	-8.93	1.32	50.63
2	-5.28	5.57	57.48
3	-1.64	9.83	64.45
4	1.94	14.06	71.50
5	5.43	18.23	78.61
6	8.79	22.29	85.75
7	11.99	26.23	92.88
8	15.00	30.00	100.00

Proposed Revision in the First Two Sentences of Section 7  
of the NAIC Standard Valuation Law

7[6]. Any cash surrender value and any paid-up nonforfeiture benefit, available under the policy in the event of default in a premium payment due at any time other than on the policy anniversary, shall be calculated with allowance for the lapse of time and the payment of fractional premiums beyond the last preceding policy anniversary. All values referred to in sections three, four, five, five-a, [and] five-b and five-c may be calculated upon the assumption that any death benefit is payable at the end of the policy year of death. In lieu of the values calculated in accordance with such procedures, minimum values may be calculated in accordance with any one or more of the following procedures: (1) upon the assumption that the death benefit is payable on any date on or after the date of death and prior to the end of the policy year of death, (2) upon the assumption that premiums are paid continuously, and (3) upon the assumption that an insured's age is based upon any generally recognized and consistently applied basis for determining insuring age.

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ATTACHMENT D

California Insurance Department  
"Sixteen Guidelines for Reserving"

January 1978 Draft

This is to clarify the position of the California Insurance Department with respect to the interpretation of the California Insurance Code and the valuation and nonforfeiture requirements applicable to life and annuity products. This constitutes no change from interpretations previously rendered and is intended to be used as a reference by insurers writing such business in the State of California.

1. Valuation and nonforfeiture provisions of the Code are to be applied to group permanent plans in the same manner as to individual plans. However, mortality tables allowed for group plans may be used for group permanent.
2. Annuity reserve requirements apply also to individual insurance funds on deposit such as premium deposit funds, advance premium deposits or any deposits regardless of title.
3. Annuity reserve requirements apply to supplementary contracts with or without life contingencies.
4. For reserves and values using continuous functions:

$$(a) \quad \bar{D}_x = \int_0^1 D_{x+t} dt$$

By assuming that  $D_{x+t}$  is linear for  $0 \leq t \leq 1$

$$D_x = 1/2 (D_x + D_{x+1})$$

By assuming that deaths in the year of age  $x$  to  $x+1$  are uniformly distributed over that year of age

$$\bar{D}_x = [(\delta - d)/\delta^2] D_x + [(i - \delta)/\delta^2] D_{x+1}$$

Where  $d = iv = i/(1+i)$

$\delta$  = force of interest

$i$  = interest rate

$$(b) \quad \bar{C}_x = \int_0^1 D_{x+t} / A_{x+t} dt$$

By assuming that deaths in the year of  $x$  to  $x+1$  are uniformly distributed over that year of age

$$\bar{C}_x = (i/\delta) C_x$$

By assuming that the total deaths are concentrated at the middle of the year of age

$$\bar{C}_x = (1+i)^{1/2} C_x \text{ or } (1+i/2) C_x$$

5. The use of age-nearest-birthdate or age-last-birthdate mortality assumptions is permitted in the determination of minimum reserves or minimum nonforfeiture values depending upon the assumptions used in calculating the premiums for the plan so valued. Subsection (f) of Section 10160 of the California Insurance Code states:

(f) A brief and general statement of the method to be used in calculating the cash surrender value and the paid-up nonforfeiture benefit available under the policy on any policy anniversary beyond the last anniversary for which such values and benefits are consecutively shown in the policy with an explanation of the manner in which the cash surrender values and the paid-up nonforfeiture benefits are altered by the existence of any paid-up additions credited to the policy or any indebtedness to the insurer on account of or secured by the policy.

The brief and general statement should include the nonforfeiture factors needed to determine the values beyond the last anniversary for which values are shown in the contract.

6. Only curtate functions are permissible in the determination of minimum nonforfeiture values, while for the determination of minimum policy reserves either curtate or continuous functions are permissible.
7. Joint life reserves and cash values may be calculated by treating the joint life table as a single life table and applying the Standard Laws accordingly.
8. Additional reserves for convertibility and renewability are desirable but not mandatory provided such new policy is a regular ratebook plan at regular ratebook rates. Otherwise additional reserves are required.
9. Reserves should be set up for additional benefits incorporated in a policy (e.g. accident indemnity and premium waiver without regard to the existence or nonexistence of a separately identifiable premium charge).
10. Any benefit with a specific premium charge must be reserved for.
11. Riders and basic policies should be considered separately for valuation and nonforfeiture purposes, however, the substance of the policy will be considered so that this procedure cannot be used to circumvent the requirements of the Code (e.g. splitting up an endowment policy into an annuity plus term rider).
12. Pure endowments will not be considered in the determination of equivalent level amounts for valuation and nonforfeiture purposes.
13. For renewable term insurance if the premium for a renewal period commencing at a given attained age is independent of the original term insurance issue age for the same term insurance benefits at that given attained age of the insured, that period shall be treated separately for valuation purposes.
- For a term conversion if the premium for a converted plan commencing at a given attained age is independent of the original term insurance issue age for the same term conversion benefits at that given attained age of the insured, that converted plan shall be treated separately for valuation purposes.
14. For the calculation of premium deficiency reserves or excess interest guarantee reserves, sufficiencies may not offset deficiencies.
15. Annuity reserves shall at least equal the greatest of any of the discounted values of cash surrender values available after the date of valuation, such cash values discounted to the valuation date at the maximum permissible statutory interest rate.
16. Flexible premium annuities shall be valued only as to the accumulation of paid premiums without assumptions as to the amounts of future payments. Premiums received are not single premiums for the determination of allowed statutory interest.

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## ATTACHMENT E1

To: David M. Holland, FSA  
Vice President and Actuary  
Munich American Reassurance Company  
P.O. Box 3210  
Atlanta, Georgia 30302

From: George Harding, FSA  
Vice President  
University Life Insurance Company of America  
P.O. Box 68192  
Indianapolis, Indiana 46268

Date: March 21, 1978

Re: Guidelines for Approval of Deposit-Term-Type Insurance

As I mentioned to you, University Life objects strongly to the ACLI draft of "Guidelines for Approval of Deposit-Term-Type Insurance." Some of our reasons are detailed below. In any event, we do not believe that enough thought has gone into its development, if such a guideline is required at all. We strongly urge that it be given more careful consideration, for as it stands, it will adversely affect the interests of the insurance-buying public rather than protect them.

This letter was developed rather hurriedly, so many of the ideas are not developed as thoroughly or forcibly as could be done; further, it was not possible to do the thorough asset share analysis that should be done. I apologize for this, but time precluded it.

The Guideline is apparently to be adopted by a state, if desired, as a regulation. The authority of a Commissioner to enact such a regulation is certainly questionable, since only the legislature has the authority to change the law. If it is intended that the law be changed, it would seem more appropriate to either install the new standard nonforfeiture value formula or wait until the new mortality table is constructed. All the arguments for not changing the standard nonforfeiture value formula now apply equally for deposit-term-type products and more traditional products.

We believe that any regulation, guideline or law should not single out a class of products, but rather should be nondiscriminating in nature. If the current formula doesn't work properly, change it; don't set up a separate standard for some policies.

We believe that the current formula produces equitable results, even though there may be no cash values at all for nine years. The plan is designed to improve persistency, which it in fact does. The consumer can choose or not choose the plan, depending on his evaluation of the importance to him of forfeiture involved. It is not illogical or inequitable to provide a higher cost for those who terminate early; to the contrary, it is quite logical and most equitable.

We believe that the Guideline is neither necessary nor desirable. In most states, the Commissioner would not have authority to effect its requirements or any requirements other than those prescribed by law. Thus, it will generally require a change in the Standard Nonforfeiture Law to effect the Guideline. But this is exactly what is trying to be avoided, because of time delay involved and because a general change is upcoming.

It seems clear to us that the Guideline is unnecessary, undesirable and, even if it were necessary and desirable, premature. Its implementation would cause severe problems for the companies which sell such insurance, such as: reprinting all such policies; increasing the gross premium charged for such policies; and decreasing the commission allowable on such policies. The Guideline, as currently written, sounds the death knell of deposit term and other similar policies, which would be a significant setback for companies, marketing forces, and most importantly, insurance purchasers.

The purpose of deposit term is two-fold: (1) to provide a better buy for the consumer who intends to keep his insurance; and (2) to provide an adequate level of compensation for the selling agent.

The insurance company also benefits by having a longer-lasting block of business on its books -- less surplus needs to be devoted to the nonproductive purpose of replacing older terminating policies with new ones.

The techniques used in pricing deposit term and modified premium whole life policies is in no way different than the techniques used in pricing all other life insurance plans: the cost of benefits provided by the policy plus expected expenses is evaluated by use of profit studies and asset shares, developed from assumptions as to mortality, interest and persistency. Gross premiums are set so as to cover benefit and expense costs and to provide a profit satisfactory to the company. The cost of benefits includes the cost of providing the desired level of cash values; this cost is a function not only of the cash values but also of the expected lapse rates. Thus, increasing cash values in any way will increase the cost of this benefit and will either reduce the company's profit or will require increasing the gross premium so as to pass this additional cost on to the purchaser.

The effect of the Guideline on University's policies has not been completely analyzed yet, but initial tests show that it would require cash values in excess -- in some cases, greatly in excess -- of the asset shares. In the extreme case shown in the examples attached to the Guideline, the first-year cash value is more than the \$50 additional first-year premium -- a result which is clearly unreasonable.

The cash value requirements of the Guideline do not follow the statement quoted on page 5; if the principles of this statement were followed; considerably lower values would be required in most years. In fact, the wording of several parts of the Guideline show a lack of basic understanding of deposit term contracts. For example:

1. The contracts are likened to "tontine-type agreements." This is an improper description. The values available on termination or on survival are defined in advance and are available to each survivor; the value under a tontine arrangement is not known in advance, and it depends significantly on the number of survivors.
2. The purpose of the deposit is to cause persistency to be improved and to enable payment of a higher commission than can be paid on term insurance generally. The "pegged" cash value admittedly does not arise from an interest accumulation of the deposit, but it is nevertheless equivalent thereto.
3. Deposit whole life and modified premium whole life -- at least at University and many other companies -- is a whole life plan, not term with an automatic conversion feature. Cash values after the tenth year progress in the same fashion as any other whole life policy, using the net level premium method. The deposit does not "disappear gradually over the life of the policy" any more than does the tenth year cash value of a whole life policy.
4. To describe deposit-term-type products as "such as to present possibilities of deception and misunderstanding" is unreasonable and unfair. There is nothing about deposit term itself which is deceptive -- this is a function of the selling agent. Deception and misunderstanding can occur for any policy, not just deposit term.
5. To label deposit term cash values as "inherently unfair" is an unreasonable statement. Deposit term provides a better buy than does whole life for both those who lapse in any year and for those who persist. This seems to me to be the epitome of equity.

In summary, we believe that the ACLI Guideline is:

1. Inappropriate, since any change in minimum cash value requirements must be legislated and should be on a nondiscriminating basis.
2. Premature, since it reflects a lack of understanding of deposit-term-type products and has not had the input of those companies which would be most affected.
3. Inequitable, since the cash values produced exceed asset shares, thus, producing the anomaly that those terminating get more than their share.
4. Unfair, to the extent that the cash values would require increasing the gross premiums, thus, increasing the cost to those who persist.

University would be happy to work with anyone on your committee who wishes further information.

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## ATTACHMENT E2

To: John O. Montgomery, Chief Actuary  
California Insurance Department

From: Ted Becker, Staff Actuary  
Texas State Board of Insurance

Date: May 4, 1978

You had previously expressed an interest in deposit term life insurance. I indicated I would try to let you know, at such time as our Board took any official action on this subject.

On Friday, April 29, 1978, our Board issued Board Order No. 33707. This is an emergency Order, effective for no longer than 120 days. I have enclosed a copy of this Order.

My understanding of this Order is that it applies only to new or amended policy forms, which are acted upon by our Policy Approval Division during the period while this Order is in effect. This Order does not have any effect on policy forms which are already in approved status.

The general subject of deposit term life insurance is still under consideration. I know that our Board does intend to issue permanent rules, but those permanent rules may or may not set the same standards for minimum nonforfeiture values described in this Order.

Please let me know if you have any questions about this Order or about deposit term life insurance.

Texas Rules for Deposit Term and Related Policies

1. Applicability

These rules apply to all insurance companies which issue life insurance policies and are doing business under any charter or certificate of authority in the State of Texas.

2. Definitions

- A. "Board" means the State Board of Insurance of the State of Texas.
- B. "Commissioner" means the Commissioner of Insurance of the State of Texas.
- C. "Deposit Term" means those policies or plans described as "term," "modified premium term," or "modified premium whole life insurance" coverage which provide that an additional first-year premium (deposit) shall be paid in order that certain values and options will be available at the end of the initial term period which additional premium (deposit) is typically forfeited if the policy terminates for any reason in its early years other than for death of the insured.
- D. "Policy" means the entire contract between the insurer and the insured.

3. Approval of Policy

No policy of life insurance which is characterized as a deposit term or related policy will be approved for use by the Commissioner or Board unless:

- A. The minimum nonforfeiture value under a deposit term policy shall be at least as great as the nonforfeiture value calculated by applying the Standard Nonforfeiture Law to the policy and substituting a net level annual premium for the adjusted premium for the first policy year in the determination of the excess initial expense allowance.

Such a net level annual premium shall be equal to the sum of the present value, at the date of issue of the policy, of the guaranteed term insurance benefits as specified in the policy up to the end of the term coverage period, and the present value, at the date of issue of the policy, of the pure endowment benefit specified in the policy at the end of the term period; which sum is then divided by the present value, at the date of issue of the policy, of an annuity of one per annum payable on the date of issue of the policy and on each anniversary of the policy on which a premium falls due up to the end of the term period (see the following table).

- B. The minimum nonforfeiture value under a deposit whole life insurance policy, or other modified premium life insurance policy having the characteristics of deposit term insurance, shall be determined by applying the Standard Nonforfeiture Law separately to the term coverage period and the whole life coverage period, irrespective of any language in the policy which states that the conversion to whole life coverage is automatic or that the coverage period is continuous. If a pure endowment is not paid in cash to the policyholder upon conversion to whole life insurance, minimum nonforfeiture value for the whole life insurance policy shall not be less than those computed under Standard Nonforfeiture Law for the whole life insurance coverage plus the value of the pure endowment benefit accumulated at a rate of interest specified in the policy for accumulating that benefit.
- C. The procedures for determining minimum nonforfeiture requirements in the case of deposit-term-type policies which differ from those described above, shall be appropriate modified to preserve the intent of the Standard Nonforfeiture Law.

In no event shall the calculation procedures set forth in these rules be construed as permitting any nonforfeiture value less than that which would otherwise be required in the absence of these rules.

**Example of Minimum Nonforfeiture Values Required  
Under the Guidelines for Approval of Deposit-Term-Type Products  
Deposit Term - Ten-Year Renewable and Convertible Term**

1958 CSO - 3 1/2% Curtate  
Issue Age 35

Term Insurance Benefit	\$1,020.00
Pure Endowment at End of Term	20.00
Annual Level Gross Premium	4.70
Additional First Year Premium (Deposit)	8.00
Net Level Annual Premium	5.00
First Year Adjusted Premium	17.51
Renewal Adjusted Premium	6.48

Minimum Nonforfeiture Values

<u>Duration</u>	<u>Value</u>
0	-23.64
1	-8.93
2	-5.24
3	-1.58
4	2.01
5	5.49
6	8.82
7	11.97
8	14.91
9	17.60
10	20.00

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## ATTACHMENT F

To: John O. Montgomery, Chief Actuary  
California Insurance Department

From: E.J. Moorhead, F.S.A.  
2594 Woodberry Drive  
Winston-Salem, North Carolina 27106

Date: March 24, 1978

Re: Single Premium Life Insurance

Thanks for your March 13 letter and its attachments. I shall not come to the Florida meeting.

I am keenly interested in the future discussions of the Standard Nonforfeiture Law. This interest has caused me to speak on the subject several times at Society meetings and elsewhere; I have found myself expressing doubts that do not yet seem to be shared by other actuaries.

The question of suitable interest rate for single premium life insurance is among the subjects that are much on my mind. I spoke on this in Boston last fall.

The letters from Bob Miller to Dick Minck seem to me to be just what are needed to arouse some worthwhile discussion of both (a) the limited question of the interest rate and (b) the broad question whether nonparticipating life insurance on cash value plans is at all in the interests of the buying public these days.

Referring specifically to Bob Miller's letter of June 1, 1977, would you care to ask him please to send along the figures for the same example as the one he gives starting with the last line on his first page, but using the actual single premium rates in use today instead of the hypothetical rate that he employed?

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## ATTACHMENT G

To: John O. Montgomery, Chief Actuary  
California Insurance Department

From: W. Keith Sloan  
Arkansas Insurance Department

Date: January 23, 1978

Re: Net Premium Valuations

This is probably the last communication you will have from me until after I have put my black hat back on, but some of the problems I have been having with one company regarding valuation of health insurance has just a little bit concern over the aspect of relying on net premium valuations exclusively.

One of the purposes which has been mentioned for having loading in valuation tables and for having fairly substantial margins in the assumptions of valuation interest rates is the implicit provision for expenses especially in the area of paid up policies. Unfortunately, I seriously doubt that many of the persons who set up reserve structures for the small to medium-sized companies have enough sophistication or if they have enough sophistication, have enough say as to what actually is done in the companies to determine whether a particular reserve structure actually does this or not, and I am again being quite concerned over the use of standard mortality for valuation of guaranteed issue business which is being done. One of the reasons given for the use of the 1958 CSO Table for valuing this business especially at the higher ages is that it is approximately the same as population mortality and that is approximately what is expected. The expectation is probably a reasonable one but this does imply the use of the entire margin in the table leaving none for expenses.

What I am proposing for consideration by the appropriate portions of the task force and associated groups of review and commentary personnel is that some sort of test to be developed as to the adequacy of a reserve structure. My initial thoughts are that where a company is on GAAP that the GAAP assumptions themselves be tested and that in addition to the current benefits and expenses reserves, the latter of which is a reserve for unadvertised initial expenses and explicit expense reserves be set up for future expenses. Current inflation should enter into this reserve. Then the net of the GAAP reserves plus the future benefit reserves could be compared with the net premium reserve structure being used. This would probably be sufficient for a minimum size company. For smaller companies, it would be desirable to take fluctuations of all elements into account explicitly.

These tests I would further suggest would be most appropriately a part of the examination structure and not a reporting requirement on an annual basis. For computerized departments it might be desirable to have GAAP assumptions filed with policies.

These apply both to life business and to health insurance, and I would suggest that Paul Barnhart's group might be the appropriate one to explore these possibilities especially since the experience tables as opposed to valuation tables are permitted in health insurance.

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#### ATTACHMENT H

To: John O. Montgomery, Chief Actuary  
State of California

From: Jerome S. Golden, F.S.A.  
Vice President and Actuary  
Equitable Variable Life Insurance Company  
1285 Avenue of the Americas  
New York, New York 10019

Date: March 29, 1978

Re: Variable Annuity Nonforfeiture Regulation

Because of a conflict in scheduling, I will not be able to attend the meeting of your task force in Tampa on April 6 and 7. As I promised at an earlier meeting, I am sending you a marked up copy of the NAIC Model Variable Annuity Regulation incorporating the proposed section on nonforfeiture benefits.

Also attached is a letter from Harold Leff of Metropolitan to Dick Minck of the ACLI recording some of Metropolitan's comments on the proposed variable annuity nonforfeiture regulation. Although I am sympathetic with several of the points raised in the letter, our advisory group considered similar issues and decided that consistency with the fixed annuity nonforfeiture law was the overriding objective. If you would like our advisory group to reconsider these issues, we would be happy to do so on a timely basis.

#### ARTICLE VI

[Section 3. (c) A provision specifying the options available in the event of default in a periodic stipulated payment. Such options may include an option to surrender the contract for a cash value as determined by the contract, and shall include an option to receive a paid-up annuity if the contract is not surrendered for cash, the amount of such paid-up annuity being determined by applying the value of the contract at the annuity commencement date in accordance with the terms of the contract.

(Note: The Committee would recommend inclusion of provisions dealing with grade and reinstatement [and nonforfeiture] only if the law of a particular state requires these on individual fixed dollar deferred annuities. Several companies issuing variable annuity contracts do not require contractholders to make periodic stipulated payments. If a contractholder ceases making payments he may resume doing so thereafter at any time. It is assumed that Paragraph 3(a) would be inapplicable to such contracts since the provisions described above would be regarded as more favorable to the contractholders than a 30 day grace period.)

ARTICLE VII  
NONFORFEITURE BENEFITS

*(This section should be included only if the Standard Nonforfeiture Law for Individual Deferred Annuities has been adopted in the particular state.)*

1. This Article shall not apply to any (i) reinsurance; (ii) group annuity contract purchased in connection with one or more retirement plans or plans of deferred compensation established or maintained by one or for one or more employees (including partnerships or sole proprietorships), employee organizations, or any combination thereof, other than plans providing individual retirement accounts or individual retirement annuities under Section 408 of the Internal Revenue Code, as now or hereafter amended; (iii) premium deposit fund; (iv) investment annuity; (v) immediate annuity; (vi) deferred annuity contract after annuity payments have commenced; (vii) reversionary annuity; or (viii) contract which is to be delivered outside this state through an agent or other representative of the company issuing the contract.
2. To the extent that any variable annuity contract provides benefits which do not vary in accordance with the investment performance of a separate account before the annuity commencement date, such contract shall contain provisions which satisfy the requirements of (the Standard Nonforfeiture Law for Individual Deferred Annuities) *(insert appropriate statutory citation for this law)* and shall not otherwise be subject to this Article.
3. In the case of contract issued on or after *(insert operative date of this Article, which should be at least 18 months after adoption)* no variable annuity contract, except as stated in paragraphs 1 and 2, shall be delivered or issued for delivery in this state unless it contains in substance the following provisions, or corresponding provisions which in the opinion of the Commissioner are at least as favorable to the contractholder, upon cessation of payment of considerations under the contract:
  - (a) That upon cessation of payment of considerations under a contract, the company will grant a paid-up annuity benefit on a plan described in the contract that complies with paragraph 6. Such description will include a statement of the mortality table, if any, and guaranteed or assumed interest rates used in calculating annuity payments.
  - (b) If a contract provides for a lump sum settlement at maturity, or at any other time, that upon surrender of the contract at or prior to the commencement of any annuity payments, the company will pay in lieu of any paid-up annuity benefit a cash surrender benefit as described in the contract that complies with paragraph 7. The contract may provide that the company reserves the right, at its option, to defer the determination and payment of any cash surrender benefit for any period during which the New York Stock Exchange is closed for trading (except for normal holiday closing) or when the Securities and Exchange Commission has determined that a state of emergency exists which makes such determination and payment impractical.
  - (c) A statement that any paid-up annuity, cash surrender or death benefits that may be available under the contract are not less than the minimum benefits required by any statute of the state in which the contract is delivered and an explanation of the manner in which such benefits are altered by the existence of any additional amounts credited by the company to the contract, any indebtedness to the company on the contract or any prior withdrawals from or partial surrenders of the contract.
4. The minimum values as specified in this Article of any paid-up annuity, cash surrender or death benefits available under a variable annuity contract shall be based upon minimum nonforfeiture amounts meeting the requirements of this paragraph.

The minimum nonforfeiture amount on any date prior to the annuity commencement date shall be an amount equal to the percentages of net considerations (as specified in paragraph 5) allocated to the account or accounts funding the contract increased (or decreased) by the net investment return allocated to the percentages of net considerations, which amount shall be reduced to reflect the effect of: (i) any partial withdrawals from or partial surrenders of the contract; (ii) the amount of any indebtedness on the contract, including interest due and accrued; and (iii) an annual contract charge not less than zero and equal to (a) the lesser of \$30.00 and 2% of the end-of-year contract value less (b) the amount of any annual contract charge deducted from any gross considerations credited to the contract during such contract year.

"Net investment return" means the rate of investment return to be credited to the variable annuity contract in accordance with the terms of the contract after deductions for tax charges, if any, and for asset charges either at a rate not in excess of that stated in the contract, or in the case of a contract issued by a nonprofit corporation under which the contractholder participates fully in the investment, mortality and expense experience of the account, in an amount not in excess of the actual expense not offset by other deductions. The net investment return to be credited to a contract shall be determined at least monthly.

5. The percentages of net considerations used to define the minimum nonforfeiture amount in paragraph 4 shall meet the requirements of this paragraph:
  - (a) With respect to contracts providing for periodic considerations, the net considerations for a given contract 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 that contract year less an annual contract charge of \$30.00 and less a collection charge of \$1.25 per consideration credited to the contract during that contract year. The percentages of net considerations shall be 65% for the first contract year and 87½% for the second and later contract years. Notwithstanding the provisions of the preceding sentence, the percentage shall be 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 65%.
  - (b) With respect to contracts providing for a single consideration, the net considerations used to define the minimum nonforfeiture amount shall be the gross consideration less a contract charge of \$75.00, and the percentage of the net consideration shall be 90%.
6. Any paid-up annuity benefit available under a variable annuity contract shall be such that its present value on the annuity commencement date is at least equal to the minimum nonforfeiture amount on that date. Such present value shall be computed using the mortality table, if any, and the guaranteed or assumed interest rates used in calculating the annuity payments.
7. For variable annuity contracts which provide cash surrender benefits, the cash surrender benefit at any time prior to the annuity commencement date shall not be less than the minimum nonforfeiture amount next computed after the request for surrender is received by the company. The death benefit under such contracts shall be at least equal to the cash surrender benefit.
8. Any variable annuity contract which does not provide cash surrender benefits or does not provide death benefits at least equal to the minimum nonforfeiture amount prior to the annuity commencement date shall include a statement in a prominent place in the contract that such benefits are not provided.
9. Notwithstanding the requirements of this Article, a variable annuity contract may provide under the situations specified in (a) or (b) below that company; at its option, may cancel the annuity and pay the contractholder its accumulated value and by such payment be released of any further obligation under such contract:
  - (a) If at the time the annuity becomes payable, the accumulated value is less than \$2000 or would provide an income the initial amount of which is less than \$20 per month; or
  - (b) If prior to the time the annuity becomes payable under a periodic payment variable annuity contract, no considerations have been received under the contract for a period of two full years and the total consideration paid prior to such period amounted to less than \$2000.
10. For any variable annuity 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 paragraph 4, 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 Article. 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.

[Renumber the Following Articles]

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To: Richard V. Minck  
Vice President and Chief Actuary  
American Council of Life Insurance  
Washington, D. C. 20006

From: Harold Leff  
Assistant Actuary  
Metropolitan Life  
New York, New York 10010

Date: February 23, 1978

Re: Nonforfeiture Regulation for Variable Annuities

A model nonforfeiture regulation for variable annuities has been prepared and submitted to the NAIC Task Force on Valuation and Nonforfeiture Value Regulation. We would like to offer the following comments on the proposed model.

Variable annuities are, as you know, tightly regulated at the federal level through the Securities and Exchange Commission (SEC). Variable annuities cannot, in most instances, be sold without prior compliance with a number of federal acts (e.g. 1933 Act, 1934 Act and 1940 Act) dealing with such aspects as disclosure, fraud, distribution, administration, maximum sales charges, etc. We question whether there is a real need for additional regulation at the state level on variable annuities. We are concerned that additional regulation could result in dual regulation at unjustifiable extra expense to insurance companies which would ultimately be borne by contract owners. It is our opinion that additional state regulation is unnecessary and unwise.

However, since a model nonforfeiture regulation has already been proposed, we would also like to offer the following specific comments on the proposed model, which are by no means meant to be exhaustive.

(1) Minimum Nonforfeiture Amounts (Paragraphs 4 and 5 of the Model)

In the determination of the minimum nonforfeiture amounts, the model makes provision for a collection charge of \$1.25 per consideration credited and an annual administrative contract charge of \$30 (or, if less, 2% of the contract value when no considerations have been credited during the year).

We question whether the law should be setting a specific level of administrative charges for variable annuities, since we believe there is more rationale to determining the administrative allowance from the administrative and transaction charges specified in the contract. We submit the following reasons:

- (a) Variable annuity charges must be approved by the SEC and must be specified in the contract and prominently disclosed.
- (b) Expenses in the accumulation period, as opposed to the payout or annuity period, need not be guaranteed in a variable annuity contract. (For example, in Metropolitan's contracts, the right is reserved to increase certain charges in the accumulation period - any such increases are subject to SEC approval and require prior notification to the contract owner). If expenses are not guaranteed in the accumulation period and if the law is to set a specific level of administrative charges, then it is important that the law also provide for future inflationary increases in administrative expenses. Unlike the situation for fixed annuities where increases in expenses can be provided for from dividends, e.g. from interest earnings in excess of the minimum accumulation rate of 3% interest required by the nonforfeiture law for fixed annuities, there is no such corresponding margin for variable annuities.

- (c) A flat \$30 administrative charge is inappropriate since it does not recognize that (i) different types of transactions (e.g. full or partial redemption, transfers between fixed and variable accounts, etc.) may incur different costs and (ii) costs for a particular contract will depend on transaction activity and type of transaction. The variable annuity contracts of many companies make provision for a fee on a per transaction basis, with variation of this fee by type of transaction. In a given contract year, the resultant total of these fees may well exceed \$30 for a contract with considerable activity.

If administrative charges are to be specified in the model, then the form of the charges should be more flexible and the level of such charges much broader. We feel these two objectives are best achieved by providing that such charges be computed from "those specified in the contract." As mentioned previously, these charges are required by regulation to be prominently disclosed both in the contract and in the Prospectus.

(2) Right to Cancel Annuity (Paragraph 9 of the Model)

(i) Subsection (a). The right is given to cancel the contract if, at the time the annuity becomes payable, the accumulated value is less than \$2000 or would provide an initial income of less than \$20 per month.

We feel that the \$2000 and \$20 limits are restrictive and could be totally inadequate in the future when current contractholders retire (which could be many years from now). More responsiveness to change could be provided for in the model, for example, by adding to the above subsection: "... or such limits as may be specified by regulation, if greater." The New York Insurance Department, for example, has recently approved limits higher than the above \$2000.

(ii) Subsection (b). A company may cancel a contract in the accumulation period if no consideration has been paid for two full years and total considerations paid prior to such period is less than \$2000.

The \$2000 limit ignores the effect of partial redemptions. For example, a contract owner may have contributed \$2000, but redeemed \$1500 of account value. The justifications for this subsection, in our opinion, are: (a) it is uneconomical to administer inactive contracts with small accumulated values and detrimental to premium paying contract owners; and (b) the yearly administrative charges will be, in the long run, more detrimental than cancellation to a small size contract which remains inactive. On this basis, we feel that the \$2000 consideration limit should either be restated in terms of account value or adjusted for any partial redemptions made under the contract.

(3) Provision for a Surrender Charge

The nonforfeiture law for fixed annuities incorporates additional allowances in case of surrender for cash prior to maturity, while the model law for variable annuities does not.

The risk of loss on surrender, although of a different nature than for fixed annuities, is just as real for variable annuities. While for fixed annuities the risk is primarily one of a market value loss, for variable annuities the risk is one of expense loss. Although the model provides for "percentages of consideration" equal to 65% in the first year and 87½% in renewal years, in actual practice, the resulting expense allowances of 35% and 12½% will be unavailable to a company. The reason is that due to the SEC limitations on sales loads, the withdrawal values in a variable annuity contract will be computed from higher percentages of consideration than the above 65% and 87½%. (Excess first-year expenses would typically be recovered gradually over a number of years.)

We feel that the model law for variable annuities should provide for a surrender charge, and we must make sure it falls outside SEC jurisdiction over sales loads.

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