Statement by
Julius Vogel
Senior Vice President and Chief Actuary
Prudential Insurance Company of America
Newark, New Jersey
on Behalf of the
American Council of Life Insurance

My name is Julius Vogel. I am Senior Vice President and Chief Actuary of the Prudential Insurance Company of America. I am also chairman of the Subcommittee on Cost Comparisons of the American Council of Life Insurance. I am appearing on behalf of the Council, whose 509 companies account for about 95 percent of the total life insurance in force in this country. Accompanying me today is Richard V. Minck, Executive Vice President of the Council.

On behalf of the Council, we strongly urge that your task force not submit the proposed Model Life Insurance Disclosure System Regulation to the NAIC for adoption. We also urge that the task force not release the draft report distributed with the proposed regulation without substantial reconsideration.

Before discussing why we disagree with considerable segments of the task force report and recommendations, we would like to express disappointment with the recent operations of the task force. Although its proposal calls for an entirely new cost comparison system that is radically different from the current system, the task force did not elicit comments on this new system from any segment of the industry before deciding on its recommendations. Then, the task force scheduled a hearing to be held less than three weeks following the release of its proposal and report, which collectively took up more than a hundred pages, yet urged those wishing to submit written testimony "to do so well in advance of the hearing date"! Certainly, the importance of the regulation, if not the length of the report, suggests that time be given for thoughtful and careful review, not only by the business but also by regulators.

I. Why the Task Force Should Postpone Action and Reconsider Recommendations

The following are some of the reasons why we feel very strongly that the task force should postpone action and reconsider its recommendations concerning a new model regulation. We will elaborate further on some of these points in a later section.

1. Suitability Form Objectionable and Inadequate. This proposed form is oversimplified, incorrect, and a feeble subsitute for the work of the agent. The form does not measure income needs of the applicant if he survives nor insurance needs at different times. It casts no light on whether an individual needs term insurance, permanent insurance or an annuity or some combination of these. The form assumes a certain family-type situation that in many cases will be either inapplicable or irrelevant, such as where the prospect is unmarried or where the insurance is being sold to meet business needs. Even assuming a family situation, how can a spouse's "retirement needs" be automatically measured without giving any regard to the spouse's age? In determining the insurance need on the form, any equity the applicant may have in a home is a subtractive item; does this mean that the beneficiary is expected to sell the home in all cases? Yet the form makes no provision for rental expenses for the beneficiary and any dependents. In short, it is not possible to devise a form to fill the function of an agent in determining needs; certainly, this form does not come close to filling that role successfully.

2. Preliminary Disclosure Defective and Misleading. The Preliminary Policy Summary required by the regulation would have to be prepared at the company offices, thus delaying the time at which the consumer can apply for coverage. The information on the Preliminary Policy Summary, including the Probable Cost Index, will be inaccurate for policies issued on a basis other than applied for, such as with a substandard rating.

3. Policy Summary Confusing Because of Volume of Required Data. Concerning the current Model Regulation, the task force report states that "the use of six different values (i.e., surrender cost, net payment, and ELAD for ten and twenty durations) can be quite confusing to the consumer." The task force then proceeds to recommend a Policy Summary involving over sixty indexes and a great amount of other required information!

4. Proposed Aggregate Index Misrepresents Cost to Consumer. The proposed Probable Cost Index is based on an assumed pooling of financial experience and therefore has no connection with the cost of the policy to the individual consumer. The index is the result of a complex calculation based on aggregage assumptions that are unlikely to be appropriate to any individual consumer. Certainly, they would be inappropriate to measure the prices charged by any particular company. Thus, the Probable Cost Index does not represent "the percentage of the premium dollar . . . the insurer is likely to retain for its expenses and profit." If the task force does not understand the index, how can the consumer be expected to avoid confusion?

5. Proposed Annual Indexes are Misleading and Computed on Mutually-Inconsistent Assumptions. As with the aggregate index, these annual indexes would be calculated using assumptions inappropriate for any particular buyer or company. Furthermore, the calculations are on a mutually-inconsistent basis since the interest rate used to calculate the Probable Annual Cost differs from the Yearly Rate of Return. The calculations are deisgned so that company profits and expenses all serve to first increase the Probable Annual Cost and then alternatively to reduce the Yearly Rate of Return indexes.

6. Post-Sale Annual Reports Not Useful. These involve the same indexes and therefore the same deficiencies as discussed in 4. and 5. For nonparticipating insurance, the annual table that must be exhibited for two policy years would merely duplicate figures contained in the Policy Summary furnished at issue of the policy.

7. Regulation Applies to Annuities but Requirements are Meaningless. The task force has made the proposed regulation applicable to most annuities but many of its provisions would be completely meaningless for these contracts. What relevance does Amount of Protection or either of the cost indexes have for annuities, for example? The basic purpose of an annuity is to provide a certain level of periodic income to the contractholder, but yet no provision has been made for disclosing this most basic item of information.

8. Unconditional Refund Requirements Not Authorized by Existing State Laws. Regulations requiring companies to provide unconditional refunds would only be proper if state laws required such practice or authorized commissioners to require such practices. Many states have no such laws.

9. Policy Filing Requirements Not Responsive to Statutes and Not Helpful to Regulators. The proposed requirements for filing specimen policy summaries and Probable Annual Cost graphs are outside the scope of policy approval requirements under existing statutes. Furthermore, because of the meaningless nature of the Probable Annual Cost indexes and of the other indexes required in the policy summaries, the material would be useless to the regulators.

10. Costs of Introducing New System Very Substantial. These costs, which must necessarily be borne by policyholders, would run well into the millions of dollars—all for a system of no value to the consumer.

11. Report Contains Misleading Statements. For example, from the report: "Although several states adopted the model regulation or some variant, many did not despite intense industry support for it." The fact is that 36 of the 50 states have adopted the model or a variant. How can one refer to 72% of the states as being "several states" while the remaining 14 are described as "many"? We are sure that the task force would wish to correct this and other inaccurate statements in its report before giving it wider circulation.

12. Report Lacks Balance. In many instances, the task force report fails to give a balanced presentation of issues under discussion. The strongest arguments against proposed courses of action are often omitted. For example, in advocating the elimination of ELAD, the report makes no reference to how the prospective purchaser will be handicapped by not having information concerning the relative magnitudes of guaranteed and nonguaranteed cost elements. The report contains a statement that "consumers expect and need direct numerical comparisons between par and nonpar policies" and that the policy summary should show nonguaranteed amounts on a year-by-year basis. The report omits the point that for a buyer to be able to use these annual amounts for comparisons some average, such as ELAD, is essential, just as cost indexes are needed to supplement year-by-year premium and benefit information. In other cases, an incomplete discussion is apparently due to the task force's failure to obtain reactions from industry before finally deciding on recommendations.

II. Additional Goals Proposed By Task Force are Mistaken

The task force has added several new ideas to the purpose set forth in the existing NAIC Life Insurance Solicitation Regulation. Specifically, the claim is made that "Appropriate, timely disclosure . . . to nonpurchasers, such as academicians, publishers . . . or competitors, will spur competition, improve products, and force efficiencies in the market . . . and assure that mandated disclosures and policy structures are free from material distortion."

1. Adding Such Goals Would Be Counterproductive. These additional goals have resulted in proposed changes that would be counterproductive to efforts to reach the main goal of the existing model regulation—namely, " . . . information which will improve the buyer's ability to select the most appropriate plan of life insurance for his needs, improve the buyer's understanding of the basic features of the policy which has been purchased or which is under consideration and improve the ability of the buyer to evaluate the relative costs of similar plans of life insurance."

For example, the table that would be required as part of the policy summary can have as many as eleven columns, each containing 30 entries. Two of these columns show cost indexes headed "probable annual cost" and "yearly rate of return" so that each form will contain 60 cost indexes for the basic policy and, perhaps, 60 more for each rider. Conceivably, these numbers might be of interest to a few academics. It is inconveivable that they could be anything other than a jumble to the vast majority of buyers. An array of numbers–some of which are either meaningless or deceptive–can only serve to hinder the process of disclosure.

In sharp contrast, the current model regulation requires premiums, death benefits, cash values and illustrated dividends "for the first five policy years and representative policy years thereafter sufficient to clearly illustrate the premium and benefit patterns . . . " The result is a much more useful display of numbers than would be required by the proposed model regulation.

A second example is the summary information that would be required as part of the Policy Summary under the proposed regulation. Again, a few academics might be interested in the present values constructed by the use of specified assumptions concerning mortality, lapse and interest rates. The information that purports to be "an estimate of how much you have spent, in today's dollars . . . " can only mystify a buyer. What can anyone who has simply drawn a check for $80 for the first monthly premium for a while life policy make of a statement that he has just paid $900 for protection, $2300 for surrender values, $1500 for dividends and $2100 for the company share? How can an agent be expected to give a sensible explanation for such figures?

The current model regulation gives prospective buyers numbers related to actual financial aspects of contracts, i.e., premiums, illustrated dividends, death benefits and cash values, supplemented by two cost indexes at two durations to compare possible costs of different policies. Even if state regulations were mistakenly changed to require masses of additional numbers be provided to academics or to others, there should be no requirement that individuals shopping for life insurance be burdened by such an overflow of incomprehensible data.

2. Task Force Has Not Shown Need for New Goals. To justify revolutionizing the existing disclosure and cost comparison system in order to improve competition, the task force should demonstrate the need for such efforts. No such demonstration has been attempted in the draft report.

By most standards of measurement, the market for life insurance has been very competitive during the last 30 years. Prices have decreased steadily; many new firms have entered the market; the market share of the largest companies has decreased; profits of insurance companies have been moderate; many new products have been developed and sold with varying degrees of success.

My own experience as chief actuary of a major life insurance company persuades me that the market, in fact, is very competitive and growing steadily more competitive each year. Therefore, even if the proposed regulation would result in improved competition–and I don't for a moment believe that it would–the task force has an obligation to demonstrate some need to improve competition that would justify the expenses and other problems that the proposed regulation would create.

3. The Question of Manipulation is Under Study. The NAIC has an advisory group that is struggling with the questions of the extent to which manipulation of cash values of illustrated dividends is actually a problem in the marketplace. It is certainly premature to decide, before that advisory group completes its work, that a serious problem exists and that the way to solve it is to furnish hundreds of numbers to each prospective policyholder.

One thing that has been discovered is that there are many reasons for irregularities in second differences of tables of cash values or illustrated dividends that have nothing to do with competition or the desire to make a policy look attractive. Such irregularities can result from rounding, from grading cash values into reserves at some durations, from the use of split-interest rates or many other reasons. It is not reasonable to expect the buyer of insurance to decide which of these irregularities are harmless and which are intended to deceive.

4. In Any Case, Proposals Would Not Help to Reach New Goals. Even if the task force or the advisory group were able to demonstrate that serious problems existed in the area of competition or manipulation, the proposed changes in the model regulation would not help regulators to solve such problems.

Neither the Probable Cost Index, the Probable Annual Cost, the Yearly Rate of Return nor the Company Share give the policyholder a satisfactory basis for comparing the costs he is likely to incur with different policies–whether they are similar or dissimilar. A system using more than 60 cost indexes gives many opportunities for some indexes to point one way and some the other when comparing two contracts. Therefore, comparison will be harder and the market, if affected, could become less competitive.

The opportunities for manipulation would be increased by giving too much emphasis to the Probable Cost Index. If, instead, emphasis is placed on the 30 Probable Annual Costs and Yearly Rates of Return, comparisons will be even more difficult to understand. This elaborate system would not diminish opportunities for "manipulation", except to the extent that incentives to manipulate cost indexes might be diminished if a disclosure system were to be adopted that is so extensive and so misleading that nobody pays any attention to it.

III. Examples of Disclosure Material Required by Proposed Regulation

As an aid in analyzing the task force's recommendations, we have prepared examples of the disclosure material that would be required for different policies by the proposed regulation. A review of these examples will indicate some of the reasons we find the proposals objectionable. The policies with an "A" number represent policies currently being issued by the Prudential Insurance Company. The policies with a "B" number are hypothetical policies that were developed to test various aspects of the proposed disclosure system.

1. Policy No. A1. The Probable Cost Index and the Company Share are both supposed to represent the part of the premium retained by the company for expenses and profit. However, needless confusion is introduced by stipulating that Probable Cost Index be taken as a percentage of the premiums less dividends while the Company Share be taken as a percentage of the premiums. Thus, for this policy the Probable Cost Index is 40 percent while the Company Share is 32 percent.

2. Policy No. A3. This is the same policy as A1, but the Probable Annual Cost has been calculated using an interest rate assumption of 5 percent instead of 8 percent. This one change causes the Probable Cost Index to decrease from 40 percent to 6 percent, or about 11 percent for each percentage point change in the interest rate assumption. At the same time, the Probable Annual Costs, which were distinctly positive for policy A1, have become negative for policy A3 for all except three policy years. This makes it clear that most of the so-called "probable annual cost" is simply a reflection of the difference between the interest rate prescribed by the proposed regulation and the interest rate actually used in the dividend formula.

3. Policy No. A5. For this five-year renewable term policy, the Probable Annual Costs and Yearly Rates of Return fluctuate from positive to negative for no apparent reason. How will this assist the consumer in understanding the policy and in comparing costs?

4. Policy No. A7. For this policy, the Probable Cost Index is 53 percent while the Company Share is 35 percent. The probable annual costs range from $246 to minus $148 with an annual premium in the range of $325. The yearly rate of return changes from minus 80 percent to plus 57 percent. What meaning should be attached to any of these numbers?

5. Policy No. B1. This is a hypothetical whole life policy that provides cash values equal to net level premium reserves with premiums based on mortality and interest from the Standard Valuation Law and with no provision for expenses or profit. Such a policy, if it existed, would be attractively priced because of the absence of any expense or profit loading. Yet, the Probable Cost Index and Company Share are a poor 44 percent. Looking at 30th year display, the policyholder pays a premium of $693.50 and the cash value increases by $915.00, clearly a favorable result. However, the Probable Annual Cost of $1,083 and the Yearly Rate of Return of 3.1 percent paint a gloomy picture for the policyholder.

6. Policy No. B2. This policy is the same as policy B1 except that the cash values are the minimum values required by the Standard Valuation Law instead of the higher values provided under policy B1. Paradoxically, policy B2 shows more favorable Probable Annual Costs and Yearly Rates of Return than policy B1 for 27 of the 30 policy years illustrated.

7. Policy No. B3. This policy is the same as policy B1 except that the premiums are based on twice the mortality level of policy B1. The Probable Cost Index increases from 44 percent for B1 to 62 percent for B3. Furthermore, while the mortaility level doubles in going from B1 to B3, the Protection Element remains essentially the same in dollar terms and decreases from 17 to 12 as a percentage of the premiums.

8. Policy No. B6. This is a yearly renewable term policy with premiums based on the mortality and interest from the Standard Valuation Law and with no cash values, but yet the Yearly Rates of Return are heavily negative. Like all policies in this "B" series, the Probable Cost Index is poor (48 percent) even though there is no loading in the premiums for expenses or profit.

9. Policy No. B7. While premiums for this yearly renewable term policy are at the lowest level that will enable a company to avoid establishing special reserves, the Probable Cost Index is a mediocre 40 percent.

10. Policy No. B9. This is a no-load single payment deferred annuity issued at age 40 and maturing at age 65. The contract provides a 7 percent guaranteed interest rate. While the purpose of an annuity is to provide a periodic income at maturity, there is no provision for showing this amount in any of the disclosure materials. When annuity payments commence at the end of 25 years, the indicated Probable Cost is $54,274 and the Yearly Rate of Return a negative 100 percent.

11. Policy No. B10. This is a hypothetical bank account with a 5-½ percent interest rate. Although the concept of a Probable Annual Cost is obviously inconsistent with the nature of a savings account, the prescribed calculation rules nevertheless yield positive Probable Annual Cost figures. The explanation is that these cost figures also reflect differences from the 8 percent interest rate assumption required by the regulation. Thus, companies are penalized to the extent that they cannot credit 8 percent after paying Federal income taxes.

12. Policy No. B12. The Probable Annual Costs exhibit a "sawtooth" type of fluctuating pattern, even though this is a routine, nonparticipating five-year renewable term policy. The Yearly Rates of Return are heavily negative despite the lack of cash values, and the Probable Cost Index is a poor 48 percent despite the absence of any premium loading.

IV. Examples of Defects in Proposal and Report

In the very short time available to develop comments, we have been unable to prepare a complete list of the defects in the proposed regulation and the draft report. However, we would like to list under several broad headings some of the items that have provoked reaction so far among our members.

1. Replacement of an Existing System. In evaluating the task force recommendations, it is very important to recognize that the proposed system would replace one that has been in use for several years and that forms the basis of cost disclosure that is required in 36 states and that is being furnished in over 80 percent of current life insurance sales.

   Consider the implications of replacing completely a system that is in such widespread use. Mention has been made of the very significant costs that companies will have to incur to comply with the new requirements and of who will ultimately bear these costs—the consumer. We have attempted to gauge broadly what these costs might amount to. A significant element would be the cost of educating and training sales personnel in the system. At the least, training sessions involving one or more days of an agent's time would be necessary, for which $200 would be a modest estimate of the cost of the agent's and instructor's time, accommodations, meals, supplies, etc. With some 250,000 agents in the country, a conservative estimate of the aggregate cost for merely this one element would be $50,000,000. Certainly, many millions of dollars would have to be added to this figure to provide for such expenses as the development and testing of computer systems, printing of rate book materials, designing of forms, and so forth.

   But the effects of introducing a new system would be even more far-reaching. It has been recognized that there is a definite need to improve consumer understanding of life insurance, and in this connection the importance of maintaining a certain basic stability in educational and training materials is apparent. As an example, the use of the current model regulation cost comparison indexes in sales training materials, trade publications, consumer literature, and elsewhere has helped to ingrain them in the minds of the life insurance sales force and, to an increasing extent, the public. If these indexes were replaced as a cost comparison standard, the educational progress that has been made would be largely undone and much ground would have to be retraced.

If the new system were adopted by the NAIC, the individual states would have to decide on a course of action. Some might move to adopt the new regulation, but others might elect to remain with the current regulation. During a period of some years companies that operate in more than a limited number of states would have to comply with both disclosure systems and would have to furnish different materials depending upon which regulation is in effect in the particular state. Many large metropolitan areas are spread over more than one state, and it would be inevitable that in some of these areas there will be periods where one regulation is in effect in a part of the area and the other regulation in another part. Agents in these locations would have to be knowledgeable about both systems and carry the different materials appropriate for both. Consumers attempting to discuss and compare life insurance costs with one another would be handicapped if they reside in different states with dissimilar regulations. Trade publications attempting to display data on life insurance costs would face similar problems. Again, the overall effect would be to destroy much of the progress that has been made toward improved public understanding of life insurance costs.

2. Information Unhelpful, Incomplete and Potentially Deceptive. The task force report contains the following comments concerning the current disclosure system:

> " . . . the use of six different values (i.e., surrender cost, net payment and ELAD for ten and twenty durations) can be quite confusing to the consumer. It is also subject to abuse by an agent. Consumers comparing the six values of one policy with those of another are likely to find that different indices point in different directions. Consumers are understandably confused. Furthermore, an agent can abuse the current method by emphasizing the index most favorable to his own interest."

It is ironic that the task force should then recommend a disclosure system where the required information would be overwhelming and potentially deceptive for even the most sophisticated buyers. Instead of the four cost indexes and two equivalent level annual dividend figures of the current regulation, the new one would require over sixty indexes. If the task force feels that six values can lead to agent abuse and consumer confusion, what does if feel will happen if more than ten times as many values are required?

Now consider the nature of the required information. Under the current regulation, the four indexes provide a measure of relative cost under representative situations, and the two equivalent level annual dividend figures indicate the extent to which nonguaranteed dividends are reflected in the indexes. Each of these numbers discloses information that is meaningful, that reflects a specific situation, and that involves the assumption only of a representative interest rate. Contrast that with the indexes of the proposed regulation, which are purely of interest to academics since they represent averages for a hypothetical group of lives based on a number of assumptions that will hardly be appropriate for the prospective purchaser or the policy or company under consideration. We will now discuss why these assumptions would lead to meaningless results for the consumer.

3. Indexes Fail to Provide Meaningful Cost Disclosure. In developing the various index figures of the proposed regulation, one set of lapse and mortality rates is prescribed for use in all situations. To the extend that the lapse and mortaility experience for the policy under consideration can be expected to be poorer than provided for by these prescribed rates, the calculations required under the regulation will overstate the portion of the premoum that is actually available for expenses or profits. Conversely, more will be available for expenses and profits than indicated by the calculations if the actual lapse and mortality experience is better than provided by the assumptions. This means, for example, that the Probable Cost Indexes calculated under the regulation would overstate the "actual" retention for companies that operate extensively in the lower to moderate socioeconomic markets and for policies issued to substandard risks. On the other hand, the calculations would understate the actual retention for companies that concentrate in the higher socioeconomic markets and for policies issued to preferred or "superselect" risks. These discrepancies between the Probable Cost Indexes and the company retention that could reasonably be expected in actual practice are the result of differences that obviously exist in lapse and mortality experience among different types of market, products, etc. Just to cite briefly some very basic variations that are known to exist, lapse and mortality rates are very different for permanent life insurance compared with term life insurance compared with annuities.

An additional commment we would like to make about lapse rates is that their use in determining the Probable Cost Indexes under the regulation results in a heavy weight being given to the level of the early-year cash values. For example, about half of the company retention is accounted for in the first two policy years. This means that policies with high cash values in the early policy years, which often are designed specifically for the business and high-income markets, will tend to demonstrate favorable indexes, quite apart from the relative merits of other features of these policies.

Concerning the 8 percent interest rate assumption required by the regulation, the statement is made in the Section-by-Section Analysis that this rate "more nearly approximates the time value of most policyholders' funds." Further justification for this rate is then made on the basis that "rates hover now in the mid-teens for mortgages and approach 20 percent on other consumer indebtedness." If the interest assumption for the index calculations is to represent a reasonable after-tax rate that the policyholder could earn over the long term on future investments with security comparable to life insurance, it can be questioned seriously whether any rate should be used that is higher than an expected future passbook savings account rate adjusted for income taxes over the long term. If, as also stated on the same page, the intent is to use "an interest rate that will be neutral, that will not give an unfair competitive advantage to either participating or nonparticipating policies," then careful analysis is needed to determine what is in fact an appropriate "neutral" rate. Use of an inappropriate rate creates distortions with respect to not only participating vs. nonparticipating insurance but also term vs. whole life insurance and insurance vs. other arrangements.

Finally, it is stated that "the recommended rate more nearly approximates companies' returns on their own investments." In this connection, we would mention that in 1979 the net investment earnings rate on funds derived from ordinary life insurance operations for United States companies, after deduction for federal income taxes, was about 6-¼ percent. The policy dividends being illustrated today, which must reflect current as opposed to projected interest earnings, are based on interest earnings rates in the area of 5 to 6 percent. For nonparticipating insurance, the pricing takes account of after-tax interest rates that companies can expect to earn on monies received over the lifetime of the policy. Considering the many years for which a life insurance policy can remain in force, an 8 percent interest rate is certainly an extremely optimistic assumption for this purpose.

We see, then, that the indexes of the proposed regulation would accomplish nothing more than provide a measure relative to the lapse, mortality, and interest assumptions upon which they are based. To the extent that the actual experience for the policy under consideration is anticipated to be more favorable than provided by the assumptions, the calculated indexes will appear to be favorable, quite apart from whether the policy is priced reasonably by the insurer for the market it will be sold in or whether it provides a good value to the consumer in that market. Unlike the interest-adjusted indexes of the present regulation, the new indexes would disclose nothing at all about the cost of the policy to the prospective purchaser.

Finally, even within this limited context of providing a measure against the prescribed assumptions, the proposed indexes are flawed because of mutual inconsistencies between the Probable Annual Cost and the Yearly Rate of Return calculations. In the words of the task force report, "the Probable Annual Cost simply expresses the dollar amount which the company, on average, retains each year for its profits and expenses." But in calculating the Yearly Rate of Return no recognition is given to the fact that these profits and expenses have been accounted for in the Probable Annual Cost; rather, any provision for company profits and expenses are used to reduce the Yearly Rate of Return. The combined effect of these two calculations is to charge profits and expenses twice, with the result that the indexes become essentially whimsical and certainly of no value for cost disclosure purposes. Moreover, the interest rate that is nominally credited to the buyer in determining the Probable Annual Cost is different from the Yearly Rate of Return. Thus, the buyer is being told that, if the company credits 8 percent, the overhead in a given year is $400. At the same time, he is being told that, if there is no overhead deducted from the premium, he is being credited 5 percent interest. The format strongly suggests that $400 overhead is being charged and 5 percent interest is being credited. Probably, both figures are wrong.

Misconceptions Concerning Interest-Adjusted Indexes. Merely three sentences from the report provide considerable insight into the many task force misconceptions concerning the current disclosure system.

> Neither the surrender cost index nor the net payment index indicates cost except in the unlikely event the insured would either die or surrender at the end of the 10th or 20th policy year. At other points in time, these indices may be quite irrelevant to most policyholders. In this context it is significant to note that the average life of a policy is about seven and one-half years.

Each of these statement is inaccurate, and we will discuss them in order.

At the end of any policy year during the premium-paying period, a policyholder has simply two choices—he can continue paying premiums or he can lapse the policy. The interest-adjusted indexes address both of these possibilities, which are the only possibilities, so the reference in the first sentence to "the unlikely event" is completely inappropriate.

The following sentence makes the point that the interest-adjusted indexes are generally "quite irrelevant" except at the end of the periods for which they are calculated. These indexes are designed as cost-comparison tools. Certainly, if a policy compares favorably over 10 years and also over 20 years, there is good likelihood that it will compare favorably at other durations, and vice versa. How can the task force justify this implication that how a policy compares at certain specified points has no connection with how it compares at other points?

Finally, we turn to the statement concerning the average life of a policy. The quoted figure of 7-½ years appears reasonable as the average age of all policies currently in force. But this is certainly not the same as saying that a policy's total lifetime will average only 7-½ years, which is an interpretation that the task force seems to have made. That figure is 19.53 years, according to a LIMRA study of a few years ago. The wide difference between the two figures is explained by the rapid growth from year to year in the amount of new life insurance issued. The result is that the average age of all existing policies is influenced very heavily by the more recent issues, which of course have been in force only briefly.

5. Preliminary Policy Summary Requirement Will Have Harmful Effects. Despite the assertions to the contrary in the report, the Preliminary Policy Summary required by the proposed regulation will have to be prepared at the company offices. It is inconceivable that the agent could be expected to prepare the required material accurately, since all numbers must be shown for the amount of insurance applied for. The possibility of the agent completing the form should be considered in the light of the common situation where the applicant specifies the desired premium amount, and the agent suggests the appropriate plan and face amount of insurance. A number of these sales involve riders providing such benefits as family income or other supplemental term insurance, disability waiver of premium, accidental death, or guaranteed insurability; these would complicate the calculation even further.

The report contains the statement that "if an agent can compute the premium from a rate book, he can compute the PCI in essentially the same manner." This is simply not true. The premium factor enters into both the numerator and denominator used to calcualte the PCI, so the agent cannot merely take a published PCI per $1,000 of insurance from a rate book and multiply by the number of thousands of face amount applied for. Since the premium rate per $1,000 of insurance is not a constant amount but instead varies depending upon the amount of insurance, the PCI per $1,000 of insurance also varies with the amount of insurance. Unlike the situation for the interest-adjusted indexes, the PCI values cannot be adjusted by a single addition or subtraction process to make them applicable for different face amounts. Rather, both numerator and denominator of a fraction must be adjusted and a new division performed. The same process is necessary to take account of rider benefits, substandard ratings, and any other item that affects the policy premium.

The fact that the agent would be unable to complete the Preliminary Policy Summary has very unfavorable implications for the agent, the company and, most significantly, the consumer. For the agent and the company, the result would be considerable additional cost and reduced agent productivity, largely because of the additional call that the agent will generally have to make on the customer to deliver the summary and be able to take the application for the policy.. An even more serious consequence is the effect on the consumer, who would be denied the opportunity of applying for coverage until the agent can return with the summary. Under this procedure, there is no doubt that some people will die without insurance protection who otherwise would have been covered. Certainly, people who want insurance should be covered as promptly as possible, and any proposal that would impede this process must be considered unacceptable.

6. Proposed Regulation Unhelpful for Plan Choice. The task force report states that the proposed disclosure material will "provide information helpful for consumers to assess the relative merits of similar and dissimilar plans of insurance." We disagree strongly.

One of the new items that the task force recommends is a suitability form. This form merely develops a recommended death benefit; there is nothing on the form that addresses the question of what plan is suitable. Neither is there anything in any of the other recommended disclosure materials that touches on this point. The Preliminary Policy Summary, the Policy Summary, and the post-sale disclosure forms are all designed essentially to handle permanent, participating policies. We have seen from some of the examples that we discussed that the proposed calculation bases yield nonsensical results for products such as term insurance and annuities.

As we have indicated so often, a choice between different types of policies and products cannot be reduced to a comparison of cost indexes. If a person is interested in a pure investment, he should be looking at products offered by financial instititulons other than life insurance companies. If he is seeking a product that will provide a guaranteed level of retirement income, an annuity is indicated. If he wants life insurance protection, either whole life insurance, term insurance, or a combination is the answer, depending on various circumstances. These are the basic questions that the customer needs to address first, and they have to be addressed quite independently of what the cost indexes look like.

V. Summary

The proposed changes in the NAIC model regulation are misguided. The additional goals of increasing competition and reducing the opportunity for material distortion are introduced with no showing of need. Even if need could be shown, the methods adopted by the proposed regulation would not help reach these additional goals. The changes would make the required material much less useful for disclosure and cost comparison purposes. Thus, the buyer would have to pay for the substantial expenses incurred by companies to develop and deliver information much less useful for his purposes than that required by the current model.

We, therefore, urge that the task force not give the proposed regulation and draft report any wider circulation without first giving very serious consideration both to the report and to the proposal. If it would be helpful, we would be willing to develop more detailed comments on errors in both the proposed model regulation and the draft report. However, we think that both represent a false start, and that the task force would be well advised to take an entirely different track.

Undoubtedly, the current model regulation could do a better job of presenting needed information to buyers. Any model regulation can be improved in some respects. We suggest that the task force may profitably look for improvements in the design and delivery of information that would help buyers of insurance to make intelligent choices without making them responsible for attempts to increase competition or to minimize opportunities for manipulation. In short, develop a model regulation aimed at effective disclosure and at making comparison shopping possible.

****

Comments on Behalf of the National Association of Life Companies

Presented by: S. Roy Woodall, Jr., Executive Vice-President

On August 21, 1980, on behalf of the National Association of Life Companies, I appeared at your hearing in Indianapolis on possible modifications to the Model Life Insurance Solicitation Regulation. At that time, our association, which consists of over 200 small to medium-size life insurance companies, urged that no modification of the Regulation be made unless: (1) it was justified by a clear need of the consumer; and (2) there was equally clear evidence to prove that the incremental cost would not outweigh the alleged benefits.

Now, just three months later, we are attending this public hearing called for the purpose of receiving comments on a completely new Model Cost Disclosure regulation, the draft of which was completed just last month and which you indicate you intend to recommend for adoption next week by the NAIC.

At the time I spoke to you in Indianapolis, I believed that I was speaking in the best interest of the consumer policyholders of our companies and am equally convinced today that I speak for consumers. The life insurance industry is unique in many ways. It would be unfortunate indeed if you were to lose sight of the fact that on a daily basis agents of our member companies contact tens of thousands of consumers. Management of our companies know as well as anyone could that the consumer is best served by a simple method to assist in selection of a product. Complexity is of no help and can serve only to confuse the consumer.

As pointed out in your most recent report, the current model was developed over a period of five years of study, but it now stands condemmed by you as a "significantly defective base" for life insurance disclosure, with important defects which "can be cured only by shifting to a different disclosure system." Your report states that the issue at hand is not the transitional costs, but: (1) whether the interest-adjusted method should be retained; and, (2) if not, what method or system should replace it. If the interest-adjusted method was wounded by the criticism of the FTC and the Moss Committee Report, it has been massacred by your report.

After burying the remains of the interest-adjusted method, your report consideres five alternative bases for a new disclosure system, but all are judged lacking, and an index method from the modified company retention method is chosen instead. At the meeting of the NALC directors last week, your proposal was reviewed and discussed at considerable length. As part of our consideration we listened to the report of one NALC director who is an actuary and had received a copy of the new proposal. He was able to project the cost to his company of implementing the proposed system. This director's company does business in three states, and only this July 1 was first required to comply with the present model regulation. The company has approximately 13,000 policies in force with premium income of $4 million, and is presently writing about 4,000 new policies each year. It is presently computerized on an IBM System 3, Model 10, and has 22 home office employees and 120 agents. Our actuary-director broke down the cost of compliance as follows:

1.	Refiling of policy forms, summaries and graphs	$ 5,000
2.	Upfront Disclosure: $2.50 per annual 15,000 interviews	37,500
3.	New Application Forms (for agents attestation)	2,500
4.	Policy Summaries (10 plans at $500 per plan)	5,000
5.	Annual Disclosure Form ($2.50 per 13,000 policies)	32,000
6.	Retraining ($250 per 30 managers)	7,500
	($150 per 120 agents)	18,000
7.	Software (hardware adequate)	12,000
		$124,500

Two significant points must be emphasized: First, the cost of first year compliance ($124,500) was only slightly less than one hundred percent of that company's statutory gain for all of 1979. Second, a very high percentage of the total cost will recur on an annual basis! Such a backbreaking financial burden must of necessity become a critical issue. These realistic projections cannot be cavalierly dismissed by this task force, nor can they be nullified by the proposed discretionary exemption in cases of "irreparable harm." Common sense teaches that this exemption simply will not be utilized.

Based upon these cost figures and a comprehensive review of your proposal, it was the unanimous opinion of the directors of NALC that it was time for us to say "Wait just a minute! This is insanity!" The industry and regulators listened to the critics once before and embraced the interest-adjusted method. This was done at a considerable cost; and now, after five years, we are informed that the interest-adjusted method is outmoded and that this task force, since the August 21 hearing, has now discovered for us a new magic method. We are told in your report that our previously stated concern about costs was "unpersuasive". We urged at that time that before adopting any changes you should make a cost compliance analysis. This has not been done, even though you do acknowledge in your report that such costs "may (emphasis added) impact small companies severely, particularly very small companies with limited or no computer resources." The cost figures presented for one of our member companies with adequate computer resources more than proves this statement. However, your report concludes that the added cost argument "pales in significance to the benefits to be gained."

What benefits? Your report states that the interest-adjusted method that was supposed to benefit the consumer when it was devised five years ago has actually been used to deceive the consumer. How do we know that in another few years your magic method will not be "outmoded" and "significantly defective"? According to the November 1, 1980 issue of The National Underwriter, the CEO of a medium-sized company told the Northeast Management Forum that: "It seems that everyone and anyone wants to tell us how to sell our product. Those who advocate current disclosure statements simply do not understand the sales process." That individual went on to make a point that is of serious concern to all of us: "I am haunted by the picture of the widow going to the desk drawer after her husband's death and finding a dozen disclosure statements and no life insurance policies."

Stated another way, the real issue is the provision of adequate life insurance protection, not the accumulation of a meaningless pile of disclosure documents.

The NALC agrees that many of those who have proposed the various disclosure systems have had commendable objectives of achieving a more intelligent and informed life insurance consumer. However, the NALC also knows from experience that sometimes large companies are willing to accept additional regulatory restrictions when they know that it will be to their benefit—at the expense of the smaller companies. The NALC was founded in 1955 as a direct result of a proposal being considered by the NAIC at that time, and supported by many large companies, that would have outlawed all "specialty" policies and thereby put many smaller and more innovative companies out of business. Prior to the passage of the 1959 Tax Act, the smaller companies had to rally through the NALC to modify a tax proposal supported by the larger companies that would have been discreminatory in favor of the larger companies. As we pointed out in the August 21 hearing, the net effect of more disclosure changes will be "the sale of fewer policies at more expense." Every added cost of disclosure discriminates against the smaller companies by more heavily increasing the unit cost of its policies and it equally discriminates against the consumer policyholder who will be forced to pay a higher price for the same amount of insurance protection.

In speaking of your "commendable objectives", it is difficult not to think of the commendable objectives of the endless governmental programs that promised placebos to stamp out poverty, ignorance and illness, and with those efforts of governmental agencies over the past two decades to "protect" us all by controlling our lives. These "commendable objectives" have met with repeated failure and have now been repudiated by the voters of this country.

We respectfully suggest that the return to realism signified in the 1980 election be considered carefully by your committee. From the testimony heard here today, it will be evident that your new "majic" formula cost disclosure system will not be exempt from criticism. The "company share" figures are especially susceptible to confusion and even misrepresentation as the equivalent to the amount of company profit on the policy in question. Time may prove it to be more defective than the interest-adjusted method. Perhaps it is time to acknowledge that no system can be without fault. It may even be time to consider returning to the net cost method or to some other simplified method that could be more readily understood by the average consumer. Your own report points out that the old net cost method has the "virtue of simplicity . . . was easy for consumers to understand and easy for agents to calculate and present." None of the alternate bases for a disclosure system, including the new proposed method, has these attributes. The criticism your report levels at the simplified net cost method centers on the fact that it does not reflect the time value of money. This has never been disputed. But when the consumer is so informed of the defects in any simplified method, perhaps that is all that you as regulators can or should do without risking the confusion of more complicated systems that leave the consumer worse off than he is today.

****

November 25, 1980

Ms. Carolyn Cobb, Associate Counsel
National Association of Insurance Commissioners
350 Bishops Way
Brookfield, Wisconsin 53005

Dear Ms. Cobb:

Enclosed is a copy of the letter I received from our member company giving the cost estimates for implementing the new proposed cost disclosure system.

In reviewing my testimony, I noted that one item has been omitted, thus causing an erroneous total. The letter gives the breakdown in much better detail and should be of more assistance to you, especially in view of Commissioner Hudson's remarks to the effect that you were undertaking some independent cost studies.

Very truly yours,

S. Roy Woodall, Jr.
Executive Vice President

PRELIMINARY POLICY SUMMARY

> NOT ALL LIFE INSURANCE COSTS THE SAME.
> SHOPPING FOR LIFE INSURANCE CAN SAVE YOU MONEY.
> LOOK FOR POLICIES WITH A LOW PROBABLE COST INDEX.

Company Name ACLI Life Insurance Company Application # 0000000A1

Company Address ACLI Plaza, Washington, New Jersey 07101

Proposed Insured John D Policyowner Age: Male 35

Policy Plan Name: Estate 20 - Non Smoker

Brief Policy Description: Whole Life - Non-Smoker Discount Applies

To find a low cost policy, compare the following information with similar policies. A policy with a lower Probable Cost Index is likely to be a better buy. Small differences in Probable Cost Indexes are probably not significant. Your Buyer's Guide will tell you more about the Probable Cost Index.

PROBABLE COST INDEX 40%

		(30)	(40) Amount Payable	(50) Cash
Policy Year	Premium	Dividends*	Upon Death*	Values*
1	891.-	—	50446.-	—
2	891.-	56.-	50446	270
5	891.-	71 -	50446	2896
10	891.-	99.50	50696	8184
20	891 -	691.-	51696	19627
Age 65	891.-	1279.50	51846	28795

☑ If this block is checked, some of the above values can change. They will be indicated with an (*) by your agent. These numbers are not guaranteed.

1. Your state requires your agent to fill out this form and give you a Buyer's Guide before you sign anything or pay any money.

2. Read the Buyer's Guide. It contains basic insurance information.

3. Keep this form. Compare it with the Policy Summary that will be delivered with your policy. Check the figures.

4. The Policy Summary contains more about how much this policy will cost you. You can request it at any time. Your company's name and address is at the top of this page.

Name of Agent George G. Agent Telephone # 201-123-4567

Address of Agent 123 Main St. Anytown NJ 07117 Date: Nov. 17, 1980

Page 1

SUMMARY OF POLICY COSTS AND BENEFITS

Insured: John D. Policyowner
Policy No. 0000000A1
Generic Name: ESTATE 20-NON SMOKER

You can ask your agent or write your company to get answers to your question about this policy.

ACLI Insurance Company
ACLI Plaza
Washington, New Jersey 07101

Agent: George G. Agent
Address: 123 Main St.
City: Anytown State: NJ Zip: 07707

PROBABLE COST INDEX 40%

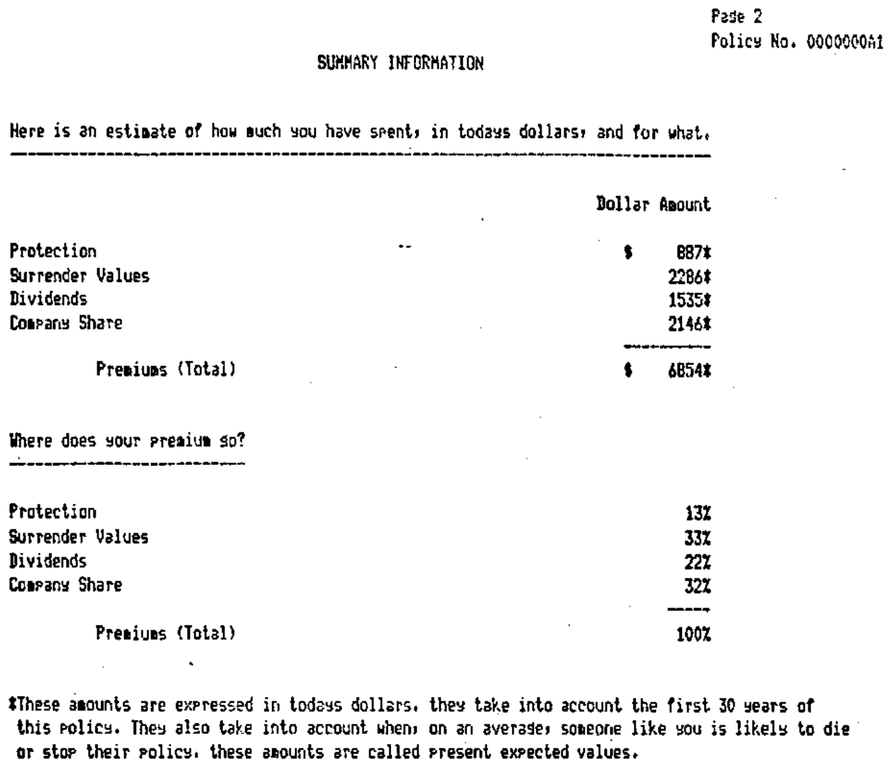
	Annual Premium	Semi-Annual Premium	Quarterly Premium	Monthly Premium
Amount Per Payment	891.00	453.00	229.25	77.50
Total First Year	891.00	906.00	917.00	930.00

(1)	(2)	(3)	(3a)*	(4)	(4a)*	(5)	(5a)*	(6)*	(7)*	(8)*
			Illustrative	Guaranteed	Illustrative	Guaranteed	Illustrative		Probable	Yearly
Policy			Annual	Death	Death	Cash	Cash	Amount of	Annual	Rate o
Year	Age	Premium	Dividend	Benefit	Benefit	Value	Value	Protection	Cost	Return
1	35	891.00	0.00	50000	50446	0.00	0.00	50446	836	-93.
2	36	891.00	56.00	50000	50446	270.00	270.00	50176	530	-56.
3	37	891.00	59.00	50000	50446	1116.00	1116.00	49330	9	7.
4	38	891.00	65.00	50000	50446	1991.00	1991.00	48455	34	6.
5	39	891.00	71.00	50000	50446	2896.00	2896.00	47550	59	5.
6	40	891.00	76.50	50000	50446	3830.50	3830.50	46615	87	5.
7	41	891.00	81.50	50000	50446	4795.50	4795.50	45650	116	5.
8	42	891.00	87.00	50000	50496	5792.00	5892.00	44604	53	7.
9	43	891.00	92.50	50000	50596	6821.50	7021.50	43574	90	6.
10	44	891.00	99.50	50000	50696	7884.00	8184.00	42512	128	6.
11	45	891.00	157.50	50000	50796	8809.50	9209.50	41586	278	4.
12	46	891.00	215.50	50000	50896	9761.00	10261.00	40635	267	5.
13	47	891.00	273.00	50000	50996	10738.50	11338.50	39657	257	5.
14	48	891.00	330.50	50000	51096	11741.50	12441.50	38654	251	5.
15	49	891.00	391.50	50000	51196	12771.00	13571.00	37625	241	6.
16	50	891.00	450.00	50000	51296	13827.00	14727.00	36569	235	6.
17	51	891.00	508.50	50000	51396	14909.50	15909.50	35486	230	6.
18	52	891.00	568.50	50000	51496	16020.00	17120.00	34376	223	6.
19	53	891.00	629.00	50000	51596	17158.50	18358.50	33237	215	6.
20	54	891.00	691.00	50000	51696	18327.00	19627.00	32069	205	6.
21	55	891.00	946.00	50000	51746	19246.50	20546.50	31199	368	6.
22	56	891.00	984.00	50000	51746	20167.00	21467.00	30279	382	6.
23	57	891.00	1022.00	50000	51746	21086.50	22386.50	29359	398	6.
24	58	891.00	1062.00	50000	51771	22004.50	23354.50	28416	366	6.
25	59	891.00	1103.50	50000	51796	22919.00	24269.00	27527	430	6.
26	60	891.00	1140.00	50000	51796	23828.50	25178.50	26617	449	6.
27	61	891.00	1177.50	50000	51796	24732.50	26082.50	25713	466	6.
28	62	891.00	1215.00	50000	51821	25629.50	27029.50	24791	434	6.
29	63	891.00	1249.50	50000	51846	26517.50	27917.50	23928	501	6.
30	64	891.00	1279.50	50000	51846	27395.00	28795.00	23051	521	6

*These figures are based on projections and may not reflect the actual values received or realized in the future.

Your Buyers Guide will tell you about the yearly rates of return. You can also ask your agent or your company to explain

In the future someone may ask you to replace this policy. If that happens, ask your agent for a new sheet like this one. You can also ask your insurance company.



Page 2
Policy No. 0000000A1

SUMMARY INFORMATION

Here is an estimate of how much you have spent, in todays dollars, and for what.

	Dollar Amount
Protection	$ 887*
Surrender Values	2286*
Dividends	1535*
Company Share	2146*
Premiums (Total)	$ 6854*

Where does your premium go?

Protection	13%
Surrender Values	33%
Dividends	22%
Company Share	32%
Premiums (Total)	100%

*These amounts are expressed in todays dollars, they take into account the first 30 years of this policy. They also take into account when, on an average, someone like you is likely to die or stop their policy, these amounts are called present expected values.