LIFE INSURANCE (A) COMMITTEE

Reference: Formerly part of Life Accident and Health (C) Committee
1981 Proc. I p. 420
1981 Proc. II p. 558
Credit Insurance (C2) Subcommittee
1981 Proc. I p. 488
1981 Proc. II p. 641
Life Insurance (C3) Subcommittee
1981 Proc. I p. 515
1981 Proc. II p. 643
Life, Accident and Health Insurance (C4) Technical Subcommittee
1981 Proc. I p. 793
1981 Proc. II p. 767

Lyndon L. Olson, Jr., Chairman – Texas
Richard G. Shaw, Vice-Chairman – West Virginia

AGENDA

1. Report of the Life Insurance Cost Disclosure Task Force.

2. Report of the Manipulation, Lapsation, Dividend Practices and Annuity Disclosure Task Force.

3. Report of the Group Life and Health Insurance Task Force.

4. Report of the Home Service Life and Health Insurance Task Force.

5. Any other matters brought before the committee.

CONTENTS

December, 1981, report 343
Semi-annual report of the Life, Accident and Health Insurance Technical Staff Actuarial Group (Attachment One) 346
Agenda for December 1981 meeting (Attachment One-A) 353
Draft copy of June, 1981 minutes of the former (C4) Technical Subcommittee (Attachment One-B) 355
Draft copy of October, 1981 minutes (Attachment One-C) . . . 363
Table of Statutory Calendar Year Interest Rates (Attachment One-D) 377
Correspondence on projects of former (C4) Technical Subcommittee (Attachment One-E) 380
Correspondence on Actuarial Guidelines (Attachment One-F) . 383
Proposed Guideline for Interpretation of NAIC Standard Nonforfeiture Law for Individual Deferred Annuities (Attachment One-F1) 384
Recommended changes to Actuarial Guideline II (Attachment One-F2) 386
Correspondence on sex distinct pricing (Attachment One-G) . . 390
Review of Sex Distinct Pricing in Individually Marketed Insurance (Attachment One-G1) 391

The Life Insurance (A) Committee met in the Grand Ballroom C of the New Orleans Hilton in New Orleans, Louisiana following the (E) Committee on December 17. A quorum was present and Lyndon Olson, Jr. chaired the meeting. The following committee members or their representatives were present: Lyndon Olson, Jr., Chairman (Texas); Richard G. Shaw, Vice Chairman (West Virginia); Robert C. Quinn (California); J. Richard Barnes (Colorado); Joseph C. Mike (Connecticut); Johnnie L. Caldwell (Georgia); Michael L. Browne (Pennsylvania); Roger C. Day (Utah); and Susan Mitchell (Wisconsin).

1. Report of the Task Force on Life Insurance Cost Disclosure

Lyndon Olson, Jr. (Texas), reported on the activities of the Life Insurance Cost Disclosure Task Force. At a meeting in Chicago the Virginia Department Study was reviewed by former Commissioner Jay Newman. The "Hudson" report on cost disclosure was also discussed. Task force Chairman Olson also noted that a work session was by passed here in New Orleans to accommodate requests to testify before the task force. Testimony was received and is reviewed in the attached task force report. He also noted that coordination between the Life Cost Disclosure Task Force and the Securities and Insurance Regulation Task Force should occur in their respective review of regulatory responses to new life insurance products such as "universal life." *The (A) Committee received that report.

* In view of the implications on cost disclosure of the new life products, no time table has been finalized for the work of the task force.

2. Report of the Task Force on Manipulation, Lapsation, Dividend Practices and Annuity Disclosure

Erma Edwards (Nevada) reported for the Manipulation, Lapsation, Dividend Practices, and Annuity Disclosure Task Force. That task force will hold a hearing in Oklahoma City in April on the proposed amendments to the current Model Annuity and Deposit Fund Disclosure Regulation and Buyer's Guide which is attached to their report. Ms. Edwards also noted that the proposed amendments to the Life Insurance Solicitation Regulation by the Manipulation Advisory Committee and the Dividend Practice Advisory Committee were submitted to the Life Cost Disclosure Task Force for review and action. The proposed amendments to Schedule M of the Annual Statement from the Dividend Practices Committee are being put in form for recommendations to the Blank Committee. Action on the proposed disclosure system and report of the Lapsation Advisory Committee was deferred, to allow review by new members until June of 1982.

A request by the task force to change its title was not adopted since the name is descriptive of activities continuing in the task force. The task force report was received.

3. Task Force on Group Life and Health Insurance

The Group Life and Health Task Force had no report.

4. Task Force on Home Service Life and Health Insurance

The status report by the Home Service Life and Health Insurance Task Force was received. A final report of that task force is planned for June of 1982.

John Montgomery (California) reviewed the ongoing activities of the Life, A&H Technical Staff Actuarial Group. (Attachment One). This report was received by the (A) Committee. After discussing the informal, advisory status of the Technical, Actuarial Group, the (A) Committee took the following action:

1) Adopted a new actuarial guideline (Attachment One-F1) entitled "Guideline for Interpretation of NAIC Standard Nonforfeiture Law for Individual Deferred Annuities."

This guideline should be referred by the Executive Committee to the proper committee so that it is included in the NAIC Financial Condition Examiners Handbook.

2) Adopted certain changes in existing Actuarial Guideline II entitled "Valuation of Active Life Funds Held Relative to Group Annuity Contracts." (Attachment One-F2).

   This guideline should be referred by the Executive Committee to the proper committee so that it is included in the NAIC Financial Condition Examiners Handbook.

3) Adopted a statement as follows, "It is recommended that the NAIC endorse the use of a risk classification system which appropriately reflects cost differences by sex or both cost differences by sex and distribution by sex as being in the best interests of buyers of insurance." *[Editor's Note – The underlined material was added by the Executive Committee. See p. 28]*

4) Continued the following projects of the technical staff:

   (a) A continued review of the standard valuation and nonforfeiture laws including the annual updating of interest assumptions generated by those laws.

   (b) A continued study of the components contributing to the development of surplus and the setting of standards for minimum surplus.

   (c) The development of experience tables for the valuation of:

      (1) Life insurance for smokers vs. nonsmokers

      (2) Individual annuities

      (3) Group annuities

      (4) Credit life and credit disability insurance

   (d) A review of special plans with unusual characteristics should be continued.

   (e) Continue the work the redrafting of the model variable life regulations.

The (A) Committee also discussed the need for The American Academy of Actuaries to provide a special group of actuaries to serve as liaison to the (A) Committee and its technical actuarial staff. Mr. Bill Odell of the academy expressed the willingness of the academy to do so.

Finally the (A) Committee heard a request from Mr. Jack Blaine for a task force to review and recommend a revision of the NAIC Model Variable Life Insurance Regulation in view of new life insurance products which may combine the features of universal life (flexible premiums) and variable life (flexible premiums) tied to an investment fund. After discussion of the need to clearly define the charge to such a task force so that it did not overlap with the current study of these new products either by the Life Cost Disclosure Task Force or the Securities and Insurance Regulation Task Force, the (A) Committee adopted a recommendation that the Executive Committee appoint such a task force.

There being no further business to come before the task force the Life Insurance (A) Committee adjourned at 12:07 p.m. subject to the call of the chair.

Lyndon L. Olson, Jr., Chairman, Texas; Richard G. Shaw, Vice-Chairman, West Virginia; Robert C. Quinn, California; J. Richard Barnes, Colorado; Joseph C. Mike, Connecticut; Johnnie L. Caldwell, Georgia; Michael L. Browne, Pennsylvania; Roger C. Day, Utah; Susan Mitchell, Wisconsin.

ATTACHMENT ONE

LIFE, ACCIDENT AND HEALTH INSURANCE
TECHNICAL STAFF ACTUARIAL GROUP

SEMI-ANNUAL REPORT
December 1981

Table of Contents and Synopsis:

Preliminary Notes	Description of Life, Accident and Health Insurance Technical Staff Actuarial Group. Synopsis of the semi-annual report to the (A) Life Insurance Committee.
Format	Descriptions and titles of the sections of the life report: "Proceedings," "Recommendations," and "Attachments."
Proceedings	Items 1 through 8 contain information concerning topics of the report, along with comments on progress of the Actuarial Group.
Item 1.	Standard Valuation Law and Standard Nonforfeiture Law for Life Insurance
Item 2.	Minimum Surplus
Item 3.	Universal Life and Related Plans of Life Insurance and Annuities
Item 4.	Mortality and Morbidity Studies:
a.	Super Select Mortality, Smoker and Nonsmoker
b.	Individual Annuities
c.	Group Annuities
d.	Disability Experience for Disability Benefits Attached to Life Insurance Policies
e.	Substandard Insurance
f.	Credit Life and Credit Disability
g.	Guaranteed Issue Plans
h.	Other Possible Studies

Item 5.	Other Special Plans - indeterminate premium plans, single premium plans with specified minimum death benefits, and other plans which can not be readily handled under traditional actuarial procedures
Item 6.	Reorganization of the Life, A&H Technical Staff Actuarial Group. Disclosure of projects and possible subgroups for various projects
Item 7.	Variable Life and Variable Annuities - proposed revision for the NAIC model variable life insurance regulation
Item 8.	Other matters
(1)	Revision of Analysis of Increase in Reserves (Page 6 of current Annual Statement Blank)
(2)	Reserve strengthening in special cases
(3)	Creation of a Society of Government Actuaries

Recommendations

(1)	Adoption of a new actuarial guideline entitled "Guideline for Interpretation of NAIC Standard Nonforfeiture Law for Individual Deferred Annuities"
(2)	Adoption of certain changes in existing Actuarial Guideline II entitled "Valuation of Active Life Funds Held Relative to Group Annuity Contracts"
(3)	Adoption of a document entitled "Review of Sex Distinct Pricing in Individually Marketed Insurance"

Attachments

No. 1	Agenda for the December 1981 meeting of the Life, A&H Technical Staff Actuarial Group *[See Attachment One-A]*.
No. 2	Draft copy of the minutes for the June 1981 meeting of the former (C4) Technical Subcommittee *[See Attachment One-B]*.
No. 3	Draft copy of the minutes for the October 1981 meeting of the Life, A&H Technical Staff Actuarial Group *[See Attachment One-C]*.
No. 4	Attachment showing the interest rates developed under the 1980 version of the Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance *[See Attachment One-D]*.
No. 5	John O. Montgomery's letter of August 7 to Board Member Lyndon Olson, Jr., chairman of the (A) Life Insurance Committee. This letter outlines the projects which the former (C4) Technical Subcommittee had been working on *[See Attachment One-E]*.
No. 6	Ted Becker's letter of November 23 to Lyndon Olson, Jr., recommending adoption of a new actuarial guideline entitled "Guideline for Interpretation of NAIC Standard Nonforfeiture Law for Individual Deferred Annuities." Also, recommending adoption of certain changes in existing Actuarial Guideline II, entitled "Valuation of Active Life Funds Held Relative to Group Annuity Contracts." Numbers (1) and (2) relating to "Recommendations" *[See Attachment One-F]*.
No. 7	Ted Becker's letter of December 4 to Lyndon Olson, Jr., recommending adoption of a document entitled "Review of Sex Distinct Pricing in Individually Marketed Insurance." "Recommendation" number (3) *[See Attachment One-G]*.

Preliminary Notes

The Life, A&H Technical Staff Actuarial Group is an informal group of state insurance department employees, most of whom are actuaries. The title is taken from the advance agenda for the December 1981 meeting of the National Association of Insurance Commissioners (NAIC).

The group has not been officially constituted and no individuals are designated as "members." Most of the individuals who have been active with the group were members of the former (C4) Life, Accident and Health Insurance Technical Subcommittee, which ceased to exist after the June 1981 NAIC meeting.

The (C4) Technical Subcommittee had been working on a number of important actuarial projects which were still in progress in June 1981. The Life, A&H Technical Staff Actuarial Group has received permission to hold meetings in October 1981 and December 1981 to discuss these projects which had not been completed. The October 1981 meeting of this group was held in Atlanta, Georgia, on October 17 and 18, immediately preceeding a meeting of the Society of Actuaries. Some recommendations were made on behalf of the group at its October 1981 meeting by consensus of the state insurance department employees present. The December 1981 meeting of the group is to be held on December 12, 13, and 14 in connection with the December 1981 NAIC Meeting.

The (A) Life Insurance Committee and the (B) Accident and Health Committee have meetings scheduled for December 17, 1981. It is expected that some or all of the uncompleted projects of the former (C4) Technical Subcommittee will be considered at these meetings, as well as the status of the Life, A&H Technical Staff Actuarial Group itself.

Format of Report

The remainder of this report consists of sections entitled "Proceedings," "Recommendations," and "Attachments."

The "Proceedings" section is arranged by topic headings, corresponding to the agenda for the December 1981 meeting of the Life, A&H Technical Staff Actuarial Group (Attachment One-A). Special attention has been given to listing the uncompleted projects of the former (C4) Technical Subcommittee, and to identifying other committees and groups which have been working on the topics. When possible, a target date for completion of work currently in progress has been given.

The "Recommendations" section identifies three matters on which the Life, A&H Technical Staff Actuarial Group has recommendations for the (A) Life Insurance Committee at its December 1981 meeting.

The "Attachments" section includes several other attachments in addition to the agenda for the December 1981 meeting of the Life, A&H Technical Staff Actuarial Group (Attachment One-A). There are draft copies of the minutes for the June 1981 meeting of the former (C4) Technical Subcommittee (Attachment One-B) and for the October 1981 meeting of the Life, A&H Technical Staff Actuarial Group (Attachment One-C). There is an attachment showing the interest rates developed under the 1980 version of the Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance (Attachment One-D). There are also three letters addressed to Board Member Lyndon Olson, Jr., chairman of the (A) Life Insurance Committee. The letter from John O. Montgomery outlines the projects which the former (C4) Technical Subcommittee had been working on (Attachment One-E). The two letters from Ted Becker relate to recommendations for the (A) Committee described in the "Recommendations" section (Attachments One-F) and One-G).

Proceedings

Items 1 through 8 below contain information concerning life insurance topics, along with comments on the current progress of the Life, A&H Technical Staff Actuarial Group. Additional information concerning some of these topics can be found in the minutes attached to this report (Attachments One-B and One-C).

In addition to the various committees and groups listed below, there is an American Academy of Actuaries Subcommittee for Liaison (Life Insurance), which is invited to comment on any topic on the agenda of the Life, A&H Technical Staff Actuarial Group. Ardian Gill, of Tillinghast, Nelson, and Warren in New York, serves as chairman of this American Academy of Actuaries Subcommittee.

1. Standard Valuation Law and Standard Nonforfeiture Law for Life Insurance

This topic is concerned with the various aspects of the comprehensive revision of these two model laws, which were adopted by the NAIC in December 1980. The Standard Valuation Law defines reserves for life insurance policies and annuity contracts. The Standard Nonforfeiture Law for Life Insurance defines minimum cash values and other nonforfeiture benefits for life insurance policies. These December 1980 model laws have already been enacted in at least 17 states.

The laws are quite complex, and some questions relating to them still need to be answered. New questions will probably arise in the future, and continued work on this topic is expected to be needed. Also, it is possible that further revision in these laws will need to be recommended later.

Attachment One-D to this report gives information on the interest rates developed under the December 1980 version of these laws.

The Technical Advisory Committee on Dynamic Interest and Related Matters was appointed by the former (C4) Technical Subcommittee in the spring of 1980. This Technical Advisory Committee is still active. It is now working on this topic and another life insurance topic, "Minimum Surplus," as well as the subtopic "Super Select Mortality, Smoker and Non-Smoker" under the topic "Mortality and Morbidity Studies." Charles Greeley, of Metropolitan Life Insurance Company in New York, serves as chairman of this Technical Advisory Committee. The Technical Advisory Committee will probably be needed to continue its work until 1984.

A special Society of Actuaries Committee has recently been formed to study one important question arising out of these laws, how to determine specifications for preparation of actuarial tables. Godfrey J. Perrott, of M & R Services, Inc., Seattle, serves as chairman of this Society of Actuaries Committee. John O. Montgomery and William H. Wetterstrand, members of the former (C4) Technical Subcommittee, are both members of this Society of Actuaries Committee. Mr. Montgomery advises that he is hopeful that this Society of Actuaries Committee can complete its work by June 1982.

This topic was described under the topic heading "Revision of the Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance" in the June 1981 semi-annual report of the former (C4) Technical Subcommittee.

2. Minimum Surplus

This topic is concerned with implementing a new principle for computing reserves for life insurance policies and annuity contracts. This new principle would include matching assets and liabilities, and defining an appropriate level of minimum surplus for each life insurance company. New legislation would be required, which would supplement or replace the present Standard Valuation Law. It is hoped that a discussion draft for model legislation can be prepared some time in 1983, and that the model legislation can then be adopted within the NAIC in the year 1984.

The Technical Advisory Committee on Dynamic Interest and Related Matters, chaired by Charles Greeley, is working on this topic. This is the same Technical Advisory Committee which is working on the previous topic, "Standard Valuation Law and Standard Nonforfeiture Law for Life Insurance." More information about this technical advisory committee can be found under that topic heading.

This topic "Minimum Surplus" was described under the topic heading "Matching of Assets and Liabilities, and Minimum Surplus" in the June 1981 semi-annual report of the former (C4) Life, Accident and Health Insurance Technical Subcommittee.

3. Universal Life and Related Plans of Life Insurance and Annuities

There is considerable interest in these types of life insurance and annuities, and a number of new varieties of plans have recently been developed. The wording of the 1980 version of the model Standard Valuation Law and the model Standard Nonforfeiture Law for Life Insurance contemplates that the commissioners of insurance for the states will issue regulations on these types of life insurance plans. It is hoped that there can be considerable uniformity in such regulations. A model regulation is needed urgently, and it should be drafted some time in 1982 and then possibly adopted by the NAIC later in that year.

In addition, it may be desirable to have actuarial guidelines for such life insurance plans and annuity plans, designed for inclusion in the NAIC Financial Condition Examiners Handbook. Work on these possible actuarial guidelines would probably have to continue into the year 1983.

Neither the former (C4) Life, Accident and Health Insurance Technical Subcommittee nor the present Life, A&H Technical Staff Actuarial Group has appointed any advisory committee or group to work specifically on this topic. However, the comments of the American Council of Life Insurance and of others who are interested in this topic have been solicited.

This topic was described under the topic heading "Completely Flexible Life Insurance Plans (Universal Life Insurance Plans)" in the June 1981 semi-annual report of the former (C4) Technical Subcommittee.

4. Mortality and Morbidity Studies

This topic is concerned with a number of different studies, most of which are now already in progress. In some cases a target date for completion can be given. The list below gives additional information on these studies.

a. Super Select Mortality, Smoker and Non-Smoker - It appears that no committee or group is presently working on actual experience tables. However, the Technical Advisory Committee on Dynamic Interest and Related Matters, chaired by Charles Greeley, is studying the question of how life insurance plans which are available only to non-smokers can be appropriately priced and reserved, possibly without the need for special mortality tables. This Technical Advisory Committee is expected to be able to furnish its views on this question in December 1981 or early 1982. This is the same Technical Advisory Committee which is also working on the topics "Standard Valuation Law and Standard Nonforfeiture Law for Life Insurance" and "Minimum Surplus," which have already been described under those topic headings.

b. Individual Annuities - The Society of Actuaries Committee to Recommend a New Mortality Basis for Individual Annuity Valuation has developed a new mortality table for valuation purposes. This table is styled as the 1983 Table "a." Robert J. Johansen, of Metropolitan Life Insurance Company in New York, is chairman of this Society of Actuaries Committee.

A 54-page exposure draft entitled "Derivation of the 1983 Table "a" for Individual Annuity Valuation" was prepared in October 1981, and copies were furnished to persons attending the Society of Actuaries meeting in Atlanta, later that month. This exposure draft contains mortality rates for the new table, along with commutation columns for various rates of interest.

The Life, A&H Technical Staff Actuarial Group plans to review this table further. It is very probable that the table will be found suitable to be recommended to the (A) Life Insurance Committee for adoption in June 1982.

c. Group Annuities - The Society of Actuaries has a parallel committee working on Group Annuities. Robert M. Chmely, of Prudential Life Insurance Company of America, Florham Park, New Jersey, is chairman of this Society of Actuaries Committee.

Members of this Society of Actuaries Committee are gathering statistics on group pension business. These statistics should be collected in early 1982, and then submitted for publication by the Society of Actuaries for its annual reports. After experience has been gathered for a reasonable period of time, perhaps five years, a new mortality table based on this experience is expected to be developed.

In the meantime, the Society of Actuaries Committee is putting together two projection scales which can be used to update the existing mortality table. This committee hopes to have an updated mortality table ready for use in 1983.

d. Disability Experience for Disability Benefits Attached to Life Insurance Policies - No work has been done on such a study as yet.

There is a Society of Actuaries Committee to Recommend New Disability Tables for Valuation, but the present charge of this Society of Actuaries Committee limits its work to a study of disability experience under accident and health policies with disability benefits. (Please see the December 1981 report of the Life, A&H Technical Staff Actuarial Group to the (B) Accident and Health Committee for more information about this other study.)

William J. Taylor, of Massachusetts Mutual Life Insurance Company, Springfield, Massachusetts, is chairman of this Society of Actuaries Committee.

e. Substandard Insurance - No work has been done on such a study as yet, although it is urgently needed.

The former (C4) Life, Health and Accident Insurance Technical Subcommittee had asked the Society of Actuaries to form a committee to work on this project, but the Society of Actuaries has felt that some of its other experience studies should be completed before any such new committee is formed. Thus, no Society of Actuaries Committee has been formed as yet for this study.

f. Credit Life and Credit Disability - The Society of Actuaries Special Study Committee – Credit insurance is currently making a pilot study of experience on the consumer finance segment of the credit insurance business written by five companies. Data for three of these companies has already been submitted. Harvey S. Galloway, of Nationwide Corporation, Columbus, Ohio, is chairman of this Society of Actuaries Committee.

This Society of Actuaries Committee is also working on credibility of experience data for credit life and credit disability insurance. A draft statement on credibility had been prepared, and was discussed at a special meeting held in October 1981 in connection with the Society of Actuaries meeting.

g. Guaranteed Issue Plans - Another area in which a study is urgently needed is mortality experience on guaranteed issue plans and other plans with limited or no underwriting selection of risks. No work has been done on such a study as yet.

The situation is quite similar to that described under the subtopic "Substandard Insurance." The Society of Actuaries has been asked to form a committee to work on this project, but this has not yet been done.

h. Other Possible Studies - At some time in the future it may be desirable to have experience studies on mortality under renewable term life insurance policies and industrial life insurance policies.

The various subtopics under this topic heading were described under several topic headings in the June 1981 semi-annual report of the former (C4) Technical Subcommittee. Please see the topic headings "Super Select Mortality," "Society of Actuaries - Mortality Studies" and "Assignment of Priorities to Society of Actuaries Projects" in the life insurance section of that report (Section four). Please see also the topic headings "Society of Actuaries Pilot Study" and "Deviation and Credibility Formulas" in the credit insurance section of that report (Section three).

5. Other Special Plans

This topic is concerned with indeterminate premium plans, single premium plans with specified minimum death benefits, and other plans which can not be readily handled under traditional actuarial procedures.

The situation with these plans is quite similar to that described previously for the topic "Universal Life and Related Plans of Life Insurance and Annuities" elsewhere in this report. The wording of the 1980 version of the model Standard Valuation Law and the model Standard Nonforfeiture Law for Life Insurance contemplates regulations on these other types of plans also. A model regulation should be drafted some time in 1982, and then it should be presented to the NAIC for adoption later in that year. Actuarial guidelines may also be needed, and work on these possible actuarial guidelines would probably have to continue into the year 1983.

No special advisory committees have been appointed to work on this topic. This topic was described under the topic heading "Other Special Life Insurance Plans" in the June 1981 semi-annual report of the former (C4) Life, Accident and Health Insurance Technical Subcommittee.

6. Reorganization of the Life, A&H Technical Staff Actuarial Group

The Life, A&H Technical Staff Actuarial Group agreed at its October 1981 meeting that it should concentrate its efforts on a reasonable number of long term projects.

The group also agreed that it should divide itself into subgroups to give detailed attention to specific matters. Each individual active in the group would be assigned to several different subgroups, according to his or her specific interests.

Five subgroups were defined for life insurance topics, and five other subgroups for accident and health insurance. The five subgroups defined for life insurance topics were:

(1) Standard Valuation Law and the Standard Nonforfeiture Laws, plus actuarial guidelines
(2) Minimum surplus
(3) Special life insurance and annuity plans
(4) Experience tables
(5) Credit life and credit disability insurance

The group intends to discuss this concept of forming subgroups in more detail at its December 1981 meeting.

This is a new topic, but it corresponds to some extent with a joint topic in the June 1981 semi-annual report of the (C4) Life, Accident and Health Technical Subcommittee, "Structure and Duties of the NAIC (C4) Technical Subcommittee."

7. Variable Life and Variable Annuities

This topic is concerned with life insurance policies and annuity contracts under which the investments supporting the benefits are held in a separate account, established by the insurance company in accordance with the variable contract law of the state in which the contract is written. Under these policies and contracts, the investment experience of the separate account is reflected in benefits, premiums or plan design.

There is a Variable Products Technical Advisory Committee which reports to the Life, A&H Technical Staff Actuarial Group. Jerome S. Golden, of Monarch Resources, Inc., New York, is chairman of this technical advisory committee.

This technical advisory committee has been working on a comprehensive proposed revision for the NAIC model variable life insurance regulation. This proposed revision would permit insurance companies to write additional plans of variable life insurance, including a product similar to universal life insurance which would be funded in a separate account.

This technical advisory committee expects to have a discussion draft of the proposed revision of the model variable life insurance regulation ready for consideration at the December 1981 meeting of the Life, A&H Technical Staff Actuarial Group. Hopefully, a version of this proposed revision will be ready to be recommended to the NAIC for adoption in June 1982.

This topic was described under the topic heading "Variable Life Insurance and Variable Annuities" in the June 1981 semi-annual report of the former (C4) Life, Accident and Health Insurance Technical Subcommittee.

8. Other Matters

The Life, A&H Technical Staff Actuarial Group is also working on several other projects including:

(1) Revision of Analysis of Increase in Reserves (Page 6 of the present Annual Statement Blank for life insurance companies.)

(2) Reserve strengthening for insurers earning less on their investments than guaranteed in their reserve accumulations and deposit fund guarantees.

(3) Creation of a Society of Government Actuaries, or a special interest section in the Society of Actuaries at some time in the future.

The June 1981 semi-annual report of the former (C4) Life, Accident and Health Insurance Subcommittee contained the topic headings "Updating of Existing Life Insurance Policies" and "General Discussion of Life Actuarial Guidelines." These are no longer considered as separate topics, and there is nothing to report under either of them in the "Proceedings" section of this December 1981 report of the Life, A&H Technical Staff Actuarial Group. There are, however, two recommendations relating to actuarial guidelines which are described in the "Recommendations" section of this report. See recommendations (1) and (2).

In future reports it is intended that any progress under "Updating of Existing Life Insurance" would be reported under the topic heading "Standard Valuation Law and Standard Nonforfeiture Law for Life Insurance." It is intended that progress on actuarial guidelines would be reported under that same topic heading, or under some other topic heading applicable to a particular guideline such as "Universal Life and Related Plans of Life Insurance and Annuities".

It should also be noted that the three projects described under this topic heading "Other Matters" were considered as joint topics in the June 1981 report of the former (C4) Technical Subcommittee. (Please see section one of that report.) Projects (1) and (2) correspond to the topic heading "Companies Earning Lower Interest Rates than the Rate Assumed in Their Reserves" in that report, and project (3) corresponds to the topic heading "Possible Organization of Government Actuaries." There is nothing to report on the joint topic "Editing and Compiling Proceedings of NAIC (C4) Technical Subcommittee."

Recommendations

The Life, A&H Technical Staff Actuarial Group has three recommendations to the (A) Life Insurance Committee for adoption in December 1981. It should be noted that recommendations (1) and (2) represent matters pertaining to actuarial guidelines which were adopted by the former (C3) Life Insurance Subcommittee in June 1981, but which did not complete all procedures necessary for inclusion in the NAIC Financial Condition Examiners Handbook. Specifically, recommendations (1) and (2) were not submitted and adopted by the former (A5) Financial Condition Examination Subcommittee.

(1) The Life, A&H Technical Staff Actuarial Group is recommending adoption of a new actuarial guideline entitled "Guideline for Interpretation of NAIC Standard Nonforfeiture Law for Individual Deferred Annuities." Please see Attachment One-F to this report. (If this actuarial guideline is adopted, it is not clear whether any additional procedure is required in order for this actuarial guidelines to be included in the NAIC Financial Condition Examiners Handbook.)

(2) The Life, A&H Technical Staff Actuarial Group is recommending adoption of certain changes in existing Actuarial Guideline II entitled "Valuation of Active Life Funds Held Relative to Group Annuity Contracts." Please see Attachment One-F to this report. (If the recommended changes in this actuarial guideline are adopted, it is not clear whether any additional procedure is required in order for these changes to be introduced into the NAIC Financial Condition Examiners Handbook.)

(3) The Life, A&H Technical Staff Actuarial Group is recommending adoption of a document entitled "Review of Sex Distinct Pricing in Individually Marketed Insurance." Please see Attachment One-G to this report. (This document relates to accident and health insurance, as well as life insurance, and it is being submitted for adoption to the (B) Accident and Health Committee in December 1981 also.)

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ATTACHMENT ONE-A

Agenda for Meeting of the
Life, A&H Technical Staff Actuarial Group

December 12, 1981

9:00 a.m. to 5:00 p.m. Magnolia Room, New Orleans Hilton Hotel, New Orleans, Louisiana

Topics Pertaining to the (A) Life Insurance Committee

(See also Monday, December 14, 1981)

1. Standard Valuation Law & Standard Nonforfeiture Law for Life Insurance

   a. Report of the Committee on Dynamic Interest and Related Matters
   b. The 1980 Model, status of enactment, interest rates for 1982
   c. Specifications for the preparation of actuarial tables
   d. Problems in interpretation
      (1) Cash values based on interest assumptions lower than interest assumed in statutory reserves, and other high cash value plans
      (2) Other problems
   e. Updating or replacing existing products
   f. Other matters

2. Minimum Surplus

   a. Report of the Committee on Dynamic Interest and Related Matters
   b. Discussion of the Wisconsin legislation and regulation
   c. Discuss the definitions of the elements of a law defining minimum surplus according to the structure of the risks assumed by an insurer
   d. Other matters

3. Universal Life and Related Plans of Life Insurance and Annuities

a. General Features
b. Interest Indexed plans
c. Reporting requirements and regulation
d. Distinguishing features as compared to variable life insurance and variable annuities
e. Other matters

4. Mortality and Morbidity Studies

a. Super select mortality, smoker vs non-smoker
b. Society of Actuaries
 (1) Individual Annuities
 (2) Group Annuities
 (3) Disability experience for disability benefits attached to life insurance policies
 (4) Substandard insurance
 (5) Credit life and credit disability
 (6) Other
c. Credibility of experience data
 (1) Credit life and credit disability
 (2) Other

5. Other Special Plans

a. Indeterminate premium plans
b. Single premium, specified minimum death benefit life insurance plans
c. Other plans

6. Reorganization of the Life, A&H Technical Staff Actuarial Group

a. Long term vs short term tasks
b. Establishment of priorities
c. Other matters

7. Other Matters

a. Revision of analysis of increase in reserves
b. Reserve strengthening for insurers earning less on their investments than guaranteed in their reserve accumulations and deposit fund guarantees
c. Special interest section in Society of Government Actuaries
d. Other

Sunday, December 13, 1981

9:00 a.m. to 1:00 p.m., Magnolia Room, New Orleans Hilton Hotel, New Orleans, Louisiana

Topics Pertaining to the (B) Accident and Health Committee

1. NAIC Premium Rate Filing Guidelines

a. Status of enactment
b. Problems
 (1) Generic group of plans experience vs single plan experience
 (2) Good experience in early policy years should result in funds being set aside for anticipated deterioration (Washington Proposal)
 (3) Other

2. Experience Tables

   a. Disability - Society of Actuaries Study
   b. Cancer and dread disease
   c. Major medical
   d. Other

3. Valuation

   a. Society of Actuaries Study
   b. Major medical
   c. Other

4. Nonforfeiture Benefits

5. Hospital and Medical Corporations

   a. Review of report
   b. Recommendations
   c. Other

6. Sex Discrimination Statement

7. Other Matters

   a. Analysis of increase in reserves
   b. Reserve strengthening for insurers earning less on their investments than guaranteed in their reserve accumulations
   c. Special interest section in Society of Actuaries and formation of a Society of Government Actuaries
   d. Other

Monday, December 14, 1981

1:00 p.m. to 4:00 p.m., Eglinton Room, New Orleans Hilton Hotel, New Orleans, Louisiana

Topics Pertaining to the (A) Life Insurance Committee

(See also, Saturday, December 12, 1981 - numbering continued from Saturday)

8. Variable Life and Variable Annuities

   a. Revision of Variable Life Insurance Regulation
   b. Other matters

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ATTACHMENT ONE-B

Minutes of the Meeting of the (C4) Life,
Accident and Health Insurance Technical Subcommittee

Detroit, Michigan
June 6 and 7, 1981

The NAIC (C4) Life, Accident and Health Insurance Technical Subcommittee met from 9:00 a.m. until about 3:00 p.m. on June 6, 1981, in the Brule Room of the Detroit Plaza Hotel, Detroit, Michigan, to consider matters pertaining to the (C3) Life Insurance Subcommittee and to Joint Topics Relating to all three Subcommittees.

The (C4) Technical Subcommittee met again from 9:00 a.m. to 1:00 p.m. on June 7, 1981, in the same hotel room to consider matters pertaining to the (C1) Accident and Health Subcommittee, and to the (C2) Credit Insurance Subcommittee.

The following (C4) Technical Subcommittee Members were present on June 6, 1981:

Ted Becker, Chairman (Texas); John Montgomery, Vice-Chairman (California); Douglas Broome (South Carolina); Erma Edwards (Nevada); Edward Flickner, Jr. (Georgia); Joe Musgrove (Arkansas).

The following person from a state insurance department was present for the meeting on June 6:

Storm Johnsen, (Washington).

The following persons attended the meetings on June 6:

W. J. Adams, Occidental Life Insurance Co.; Jim F. Allen, Federal Kemper Life Insurance Co.; John K. Booth, American Council of Life Insurance; Greg Carney, Anchor National Life Insurance Co.; William Carroll, American Council of Life Insurance; Daniel F. Case, American Council of Life Insurance; Gabe Cillie, Prudential Insurance Co. of America; Ann Enarson, Federal Kemper Life Insurance Co.; Donald L. Glick, Golden Rule Insurance Co.; Jerome Golden, Monarch Life Insurance Co.; Charles Greeley, Metropolitan Life Insurance Co.; Burnett Halstead, Federal Kemper Life Insurance Co.; George Harding, University Life Insurance Co.; Dave Holland, Munich American Reassurance Co.; Peyton Huffman, ITT Life Insurance Corporation; Harold Ingraham, New England Life Insurance Co.; Howard Kayton, First Security Life Insurance Co.; Harold Leff, Metropolitan Life Insurance Co.; Robert D. Lowden, John Hancock Mutual Life Insurance Co.; E. James Morton, John Hancock Mutual Life Insurance Co.; Paul J. Overberg, Allstate Life Insurance Co.; John Palmer, Life of Virginia Insurance Co.; Godfrey Perrott, Milliman & Robertson Services, Seattle; Paul Sarnoff, Prudential Insurance Co. of America; William M. Snell, Northwestern Mutual Life Insurance Co., Anthony T. Spano, American Council of Life Insurance; Rick Williams, E. F. Hutton Life Insurance Co.

The following (C4) Technical Subcommittee Members were present on Sunday, June 7, 1981:

Ted Becker, Chairman (Texas); John Montgomery, Vice-Chairman (California); Erma Edwards (Nevada); Ed Flickner, Jr. (Georgia); Larry Gorski (Illinois); Burt A. Gottfredson (Utah); Bill Wetterstrand (Indiana).

The following person from state insurance department was present for the meetings on June 7:

Storm Johnsen (Washington).

The following persons attended the meetings on June 7:

Noel Abkemeier, Allstate Life Insurance Co.; Paul Barnhart, AAA Liaison Committee (Consultant); John K. Booth, American Council of Life Insurance; Carroll Callaway, Health Insurance Assn. of America; William Carroll, American Council of Life Insurance; Daniel F. Case, American Council of Life Insurance; Gabe Cillie, Prudential Insurance Co. of America; Larry G. Gilbertson, Aetna Life & Casualty Insurance Co.; Thomas J. Gillooly, Health Insurance Assn. of America; Donald L. Glick, Golden Rule Insurance Co.; Peyton Huffman, ITT Life Insurance Corporation; John R. Hurley, Health Insurance Assn. of America; Donald A. Jones, Ann Arbor Actuaries, Inc., Consultants; Ken Jones, CUNA Mutual Insurance Society; Jim Olson, NAIC; Paul J. Overberg, Allstate Life Insurance Co.; Robert Shapland, Mutual of Omaha; Keith Sloan, Lumbermens Mutual Casualty Co.; William N. Snell, Northwestern Mutual Life Ins. Co.; Anthony T. Spano, American Council of Life Insurance; Peter Thexton, Health Insurance Assn. of America; William E. Timmons, Blue Cross-Blue Shield Association.

Joint Topic for (C1) Accident and Health Subcommittee Report
(C2) Credit Insurance Subcommittee Report, and
(C3) Life Insurance Subcommittee Report

I. COMPANIES EARNING LOWER INTEREST RATES THAN THE RATE ASSUMED IN THEIR RESERVES

A. Revision of Page 6 or Other Parts of Annual Statement Blank

Mr. John O. Montgomery read his letter of May 11, 1981 to Commissioner Day regarding the "Analysis of Increase in Reserves" contained in the Annual Statement Blank. The letter discussed the need for a revision in the form of the analysis and indicated the nature of the work which would be needed to accomplish it.

B. Reserve strengthening

It was agreed that this topic would be deleted from the agenda and considered under the life insurance topic "Matching of Assets and Liabilities."

II. STRUCTURE AND DUTIES OF (C4) TECHNICAL SUBCOMMITTEE

Mr. Ted Becker reported on a conversation he had had with Commissioner Day. The commissioner had asked that the subcommittee reports include comments on the significance of each agenda item and their relationship to each other.

Mr. Becker also mentioned a letter from Edward A. Flickner, dated May 19, 1981, which presented a proposal for classification of the subcommittee's agenda items. It was generally agreed that the suggestion had merit and the subcommittee planned to consider the proposal at a later date.

Mr. Montgomery pointed out the topic "Editing and Compiling of Proceedings of NAIC (C4) Subcommittee" did not appear on the agenda. He also mentioned that the NAIC had not published this material in loose-leaf form as had been intended. He and Mr. Becker planned to discuss the matter with Mr. David Vaprin of the NAIC Support and Services Office.

III. POSSIBLE ORGANIZATION OF GOVERNMENT ACTUARIES

Mr. Montgomery described his efforts to form an organization of government actuaries. He indicated that a letter discussing the subject was being prepared for mailing to all potentially interested persons.

(C1) Accident and Health Insurance Subcommittee Report

I. HOSPITAL AND MEDICAL CORPORATIONS

A. Report of Special Advisory Committee.

Dr. Donald A. Jones, a member of the Technical Advisory Committee on Hospital and Medical Corporations, answered questions from several Subcommittee members regarding his minority report. Dr. Jones said that more attention should be given to the probability of failure. The adequacy of the rate structure, the reserve position and the environment are the elements of such an analysis, he said. He stressed the point that placing too much emphasis on the reserves was like looking at the probability distribution and focusing only on the mean.

Mr. Ted Becker mentioned that he had received a letter from the advisory committee chairman, Robert H. Dobson, responding to the list of questions from the New York Insurance Department. (See Attachment 7, June 1981, semi-annual report.) Mr. Becker also mentioned that the subcommittee needed to respond to the proposals received from Mr. Roger Hahn in connection with his HMO Solvency Task Force.

Mr. Paul Barnhart mentioned that the final report of the technical advisory committee called for an opinion of a qualified actuary and that proposed wording for such an opinion was being developed by the American Academy of Actuaries Health Insurance Committee. Mr. Barnhart said that a draft would be ready for the fall meeting of the subcommittee.

II. EXPERIENCE TABLES

A. Disability - Society of Actuaries Study

Mr. Becker summarized the material in the June 1981, semi-annual report.

B. Cancer - Advisory Committee on Specified Disease Benefits

Mr. Keith Sloan, Vice-Chairman of the committee, reported briefly for the committee. (For a full report, see Attachment 9, June 1981, semi-annual report.) In response to questions from the subcommittee members, Mr. Sloan said that approximately 12 companies planned to participate in the cancer insurance benefit study.

III. VALUATION OF ACCIDENT AND HEALTH INSURANCE POLICIES

Mr. Robert B. Shapland, Chairman of the Society of Actuaries Committee for Accident and Health Valuation Principles commented on the preliminary exposure draft report which had been distributed to the Subcommittee members. Mr. Shapland stressed the point that the reserve method should take account of the rating principles.

There was considerable discussion of the following sentence which appeared on page two of the report: "We made no attempt to examine the appropriateness of NAIC principles (assuming that was not part of our charge)." Mr. Shapland explained that this referred to the fact that the report did not address what level of conservatism would be appropriate. The report, he said, dealt with valuation principles, not with practical questions such as the degree of conservatism which NAIC accounting principles may require.

Mr. Barnhart suggested that the subcommittee could divide the project into two stages. First, development of reserve principles. Second, development of guidelines for practice. He said that his liaison subcommittee would be willing to assist in the second stage.

Mr. Larry Gorski suggested that Jim Schacht of the Illinois Department might be willing to work on this project.

Mr. Barnhart and Mr. Sloan each emphasized the importance of use of consistent principles in rating, reserving, and accounting.

IV. AMERICAN ACADEMY OF ACTUARIES SUBCOMMITTEE STUDIES

Mr. Barnhart asked if the subcommittee could give him a deadline for the assignments relating to the annual statement. Since the NAIC had several important annual statement questions pending, the subcommittee did not establish definite target dates for Mr. Barnhart's assignments. Mr. Barnhart also reported that he expected that his Academy Subcommittee would have a definite proposal on the subject of an actuarial opinion on HMO reserves for the discussion at the October 1981 meeting of the (C4) Subcommittee.

V. LOSS RATIO AND MINIMUM STANDARD REQUIREMENTS (PROPOSED WASHINGTON REGULATION)

Mr. John Montgomery said that he favored the idea of the premium stablization fund contained in the Washington proposal. He mentioned that the principles involved were very similar to those discussed in the exposure draft of the report of the Society of Actuaries Committee for Accident and Health Valuation Principles.

Mr. Barnhart suggested that action on this subject be postponed until the report of that committee is adopted.

Mr. Storm Johnsen said that the Washington Department hoped to adopt a regulation by December 1981.

Mr. Donald L. Glick pointed out that the trend toward yearly renewable term rating meant that level premium reserve principles were less important. He expressed serious concern over the possibility of regulation which would force companies to return "gains" in good years, but have to suffer "losses" in bad years.

There was some discussion of whether the policyholders were being led to expect annual rate increases. Mr. Shapland said that this company, Mutual of Omaha, and Prudential are leading their insureds to anticipate annual rate increases.

Mr. Johnsen mentioned that the state of Washington was proceeding toward implementing regulations. A companion regulation covering Blue Cross and Blue Shield plans had been drafted. He thanked Mr. Barnhart for useful input in the development of the regulation.

VI. NONFORFEITURE BENEFITS FOR RETURN OF PREMIUM HEALTH INSURANCE

Mr. Becker gave a brief summary of the material included in the June 1981, semi-annual report. He noted the change in the name of the topic from "Nonforfeiture Benefits for Return of Premium Health Insurance" to "Return of Premium and Cash Value to Age 65 Health Insurance." He said that the new title indicated an expansion of the work to reserves and other actuarial problems including "Cash Value to Age 65" plans. He said that Ernie Frankovich had been making good progress in forming an advisory committee and that a meeting was being planned for June or July, 1981.

VII. COORDINATION WITH NAIC TASK FORCE ON SEX DISCRIMINATION

Mr. Gorski commented on his memorandum of March 17, 1981. (See Attachment 12, June 1981, semi-annual report.) He said that he can support separate premium rates for males and females based on current experience, but that studies of experience should continue.

Mr. Barnhart mentioned that he had sent Mr. Gorski's letter to the American Academy of Actuaries Committee on Risk Classification and to the Society of Actuaries Committees, both individual and group, on Mortality and Morbidity Experience Studies.

Mr. Peter Thexton presented a four-page report to the subcommittee. He said that the facts supported the appropriateness of rates which varied by sex and he urged the subcommittee to draw this same conclusion and to communicate this finding to the appropriate NAIC committees and subcommittees.

Mr. Thomas J. Gillooly said that the case for separate premium rates had been conclusively established. He also said that spreading the cost of normal pregnancy outside the group of persons at risk would produce unfair results.

Mr. William Wetterstrand suggested that the subcommittee was in position to make a statement, based on its investigations, that claim costs do vary by sex. Mr. Gorski also urged the subcommittee to make a statement at the June 1981 NAIC meeting, rather than wait until the December meeting. The subcommittee decided that such a statement should be prepared for discussion at its June 9, 1981 meeting.

VIII. REVISION OF NAIC PREMIUM RATE FILING GUIDELINES

Mr. Noel Abkemeier, Chairman of the HIAA subcommittee on this subject, proposed some technical amendments to the NAIC Premium Rate Filing Guidelines. The proposed changes would clarify how the guidelines would apply to rate filings made after the effective date of the guidelines on business sold prior to that date. (See Attachment 13, June 1981, semi-annual report.)

Mr. Thexton said that the changes were simple enough that they could be considered for adoption at the December 1981 meeting.

The subcommittee decided to received the proposal and consider it at its October 1981 meeting.

The subcommittee discussed the general subject of rate filing, retroactivity, and classification practices. No action was taken on these matters.

IX. OTHER MATTERS

There was no business to discuss under this topic.

(C2) Credit Insurance Subcommittee Report

I. SOCIETY OF ACTUARIES PILOT STUDY

Mr. Ted Becker noted that the 1981 semi-annual report contained a status report of this project from Mr. Harvey Galloway. (See Attachment 15, June 1981, semi-annual report.)

Mr. John Montgomery reported that he had been given a copy of the loss ratio data prepared by one of the companies participating in the study. He said that the data confirmed his belief that experience depended upon the length of the loan period.

II. DEVIATION AND CREDIBILITY FORMULAS (AD HOC COMMITTEE)

There was no report given on this item.

(C3) Life Insurance Subcommittee Report

I. STANDARD VALUATION LAW AND STANDARD NONFORFEITURE LAW

A. Comments on 1980 Model Laws

Mr. Ted Becker reported that he had written to Commissioner Barns requesting adoption of certain editorial corrections in the Standard Valuation and the Standard Nonforfeiture Law for Life Insurance.

Mr. William Carroll gave a report on the progress of the model law in the various states. Twelve state legislatures had already passed the model bill.

B. Reserves for Excess Increments in Cash Values in Certain Policy Years

Mr. John O. Montgomery reported that the California Insurance Department is still looking into one specific case where a company's reserves appear not to be adequate. The company is being asked to demonstrate that its premium rates will support the cash value structure. In response to a question from Mr. Becker, Mr. Montgomery said he planned to proceed on an informal basis without proposing any changes in the California law.

C. Report of Advisory Committee on Dynamic Interest and Related Matters

Mr. Charles Greeley, Chairman of the Advisory committee, mentioned that the advisory committee had divided its activities into four subject areas, each with its own subcommittee. He commented on the work of the Subcommittee on Cash Value Guarantees. That subcommittee had been considering whether to propose any changes in the law which requires that life insurance policies provide for cash surrender values at predetermined amounts. Mr. Greeley said that cash values available at "book value" represented one extreme. Market value adjustments represented the other. He hoped that a preliminary report on this subject would be available at the December 1981 meeting.

D. Specifications for Preparation of Actuarial Tables

Mr. Montgomery read Ardian Gill's letter of June 3, 1981. The subcommittee decided to ask the Society of Actuaries to prepare the specifications. Mr. Becker asked Mr. Montgomery to contact the Society.

II. MATCHING OF ASSETS AND LIABILITIES, AND MINIMUM SURPLUS

Mr. Greeley reported on the activities of his advisory committee's Subcommittee on Surplus and Solvency. This subcommittee plans to have research done through other groups. The Ohman Task Force of the Society of Actuaries has been appointed to study the risks associated with fluctuations in the level of prevailing interest rates. Plans will also be made to study the risk of asset default and the risk of premium inadequacy. Mr. Greeley noted that the Trowbridge Committee of the Society of Actuaries, which had identified these three categories of risk, had become more active.

Mr. Greeley said that recommendations for changes in the nature of the actuarial opinion or in the valuation laws might possible result from this activity.

III. AMERICAN ACADEMY OF ACTUARIES SUBCOMMITTEE, ORGANIZATION AND MEMBERSHIP

There was no report from the American Academy of Actuaries Subcommittee on Liaison with NAIC (C4) Subcommittee.

Mr. Greeley, a member of the board of directors of the academy, said that the formation of this new academy subcommittee had been discussed at a recent board meeting. He reported that the board members had a very positive attitude toward it.

IV. COMPLETELY FLEXIBLE LIFE INSURANCE PLANS (UNIVERSAL LIFE INSURANCE PLANS)

A. Discussion of Papers

There was no discussion of this subtopic.

B. Report of American Academy of Actuaries Subcommittee

There was no report from the subcommittee.

C. Report of Variable Products Technical Advisory Committee

Mr. Jerome Golden, Chairman of the Variable Products Technical Advisory Committee, reported on the status of the advisory committee's assignment to recommend revisions to the model variable life insurance regulation. He said that the advisory committee was presently inclined to modify present variable life insurance regulations, rather than develop a new regulation. Problems in the definition of variable life and in the distinction between variable life and other products were being addressed by the advisory committee. The current requirements that premiums be specified and that lifetime coverage be provided were mentioned as examples of items under study.

Mr. Howard Kayton, also a member of the advisory committee, mentioned that some of the restrictions in the original definition of variable life insurance had been made to avoid regulation by the SEC. He suggested that this reason no longer applied and, therefore, that some of the restrictions should be reconsidered.

Mr. Golden also reported that the advisory committee currently felt that the variable life insurance regulation should not encompass universal life, but that it should not be inconsistent with universal life insurance regulations.

The subcommittee adopted a motion calling for separate treatment of variable life and universal life. Later the motion was modified so as to make clear that the regulations, although separate, would be correlated so that the products would be regulated consistently. The subcommittee agreed that the definition of each of these products and the distinction between them should be carefully addressed in the regulations.

D. Indexed Plans

Mr. Montgomery reported that the California Insurance Department was asking companies to allocate the investments supporting indexed plans separately and to report data quarterly so that it could be determined whether yields are sufficient to cover guarantees. Margins would be required depending on the type of index used. Companies not earning the necessary interest would be asked to hold additional reserves. Mr. Montgomery asked for comments.

Mr. E. James Morton pointed out that in addition to earning the required interest, a company had to have a close matching of assets and liabilities so that the assets would be available to retire the liabilities as they matured.

Mr. Greeley mentioned that this problem - matching of assets and liabilities - is being studied by his advisory committee and by the Ohman Task Force of the Society of Actuaries. He said that the problem is one of liquidity when liabilities are shorter than assets and of reinvestment when liabilities are longer.

E. Other

At Mr. Becker's request, Mr. Daniel F. Case reported on the status of the ACLI activity. The ACLI had formed an actuarial working group which was aiming to develop suggestions for the technical subcommittee to assist it in developing model valuation and nonforfeiture regulations. The group had already met three times, and had a two-day meeting scheduled for later in June.

Mr. Case outlined the general approach which the working group was taking and mentioned some of the problems to be resolved. Nonforfeiture values would involve a retrospective accumulation of adjusted premiums which would be related to premiums paid and actual expense charges. The working party was still working on a method to express the extra first year allowance. There were also outstanding questions regarding the interest rate and the valuation standards.

Mr. Case said that the group had been making good progress and that he would report further at the October 1981 meeting.

Mr. Becker said that it was very important that this matter be completed as soon as possible.

V. OTHER SPECIAL LIFE INSURANCE POLICIES

A. Indeterminate Premium Life Insurance Plans (Adjustable Premium Plans)

Mr. Becker mentioned that Mr. Case had submitted a set of regulations from the various states which have regulated this product.

Mr. Montgomery mentioned a possible modification to the annual statement blank which would require disclosure of data somewhat analogous to that required by Schedule M.

Mr. Case said that the ACLI actuarial working group would also cover the products covered by this agenda item, but that first priority was being given to universal life.

Mr. Becker stressed the need for a regulation since it is mentioned in the new model laws.

B. Single Premium Life Plans with Specified Minimum Death Benefits

There was no separate discussion of this subtopic.

VI. VARIABLE LIFE INSURANCE AND VARIABLE ANNUITIES

The report of the Variable Products Technical Advisory Committee was discussed under Agenda Item IV-C. There was no further discussion of this topic.

VII. SUPER-SELECT MORTALITY

Mr. Greeley reported that a subcommittee of the Advisory Committee on Dynamic Interest and Related Matters was studying this subject and that he planned to report its findings at the December 1981 meeting. Mr. Greeley mentioned that the subcommittee does not see any need for new mortality tables. The primary problem was in the deficiency reserve area.

In response to questions, Mr. Greeley said that revertable term insurance would be considered, but that special questions relating to universal life insurance would not be considered.

VIII. SOCIETY OF ACTUARIES MORTALITY STUDIES

A. Individual Annuities

Mr. Becker read a report that he had received from Robert J. Johansen, Chairman of the Society of Actuaries Committee to Recommend a New Mortality Basis for Individual Annuity Valuation. (See Attachment 20, June 1981, semi-annual report.) The report stated that good progress was being made toward having an individual annuity mortality table completed during the summer of 1981 and that the Board of Governors of the Society of Actuaries had approved the distribution of the committee's report to the society members for discussion at the society's annual meeting in October.

Mr. Becker read aloud the following sentence from the report: "Separate male and female mortality rates have been produced because the Committee believes that whether or not 'merged gender' or unisex tables come into use for premium rate purposes, separate tables will be necessary for valuation purposes."

The subcommittee decided that it should go on record as opposing any prohibition of sex-distinct pricing. (For additional information on this matter, see Accident and Health Insurance, agenda item VII of these minutes, and the minutes of the June 9, 1981 meeting of the subcommittee.)

B. Group Annuities

Mr. Becker reported on the status report which he had received from Robert M. Chmely. (See Attachment 23, June 1981, semi-annual report.) In his letter Mr. Chmely mentioned that the committee was considering whether it would be feasible to update the experience underlying the 1971 Group Annuity Mortality Table with a set of improvement factors derived from an external source.

Mr. Greeley said that his advisory committee would be willing to review the results of the Johansen and Chmely committees to see what could be done. He suggested that there may currently be distinctions in mortality more significant than the individual-group distinction.

C. Possible Study of Experience on Disability Benefits Attached to Individual Life Policies, and

D. Substandard Life Insurance

The subcommittee decided to write to the Society of Actuaries and suggest that these two subjects be given to the appropriate society committees.

IX. UPDATING OF EXISTING LIFE INSURANCE

Mr. Greeley said that his advisory committee would be willing to study this topic and report its findings to the subcommittee.

EXECUTIVE SESSION

The NAIC (C4) Life, Accident and Health Insurance Technical Subcommittee met in a brief executive session on Sunday, June 7, 1981, immediately following the meeting in open session to consider certain topics relating to the (C1) Accident and Health Subcommittee Report and certain joint topics relating to the (C1) Accident and Health Subcommittee Report, (C2) Credit Insurance Subcommittee Report, and the (C3) Life Insurance Subcommittee Report.

(C1) Accident and Health Subcommittee Report

Hospital and Medical Corporations - Report of Special Advisory Committee - The report was discussed further, and it was suggested that the Technical Advisory Committee on Hospital and Medical Corporations should be asked to search for specifications for practical application of the model described in the report.

Valuation of Accident and Health Insurance Policies - After further discussion on this topic, it was agreed that it would be helpful to have the basic statutory accounting principles available for reference. Larry Gorski, of the (C4) Technical Subcommittee, was asked to try to obtain copies fo these principles, so that they could be disseminated to the other members for reference at future meetings.

(C1) Accident and Health Subcommittee Report,
(C2) Credit Insurance Subcommittee Report, and
(C3) Life Insurance Subcommittee Report

Structure and Duties of (C4) Technical Subcommittee - Jim Olson of the NAIC Support and Services Office was present at this meeting in executive session, and there was further discussion concerning publication of the proceedings of the (C4) Technical Subcommittee.

Companies Earning Lower Interest Rates than the Rate Assumed in Their Reserves - Revision of Page 6 or Other Parts of the Annual Statement - After further discussion of this topic, the (C4) Technical Subcommittee agreed to reaffirm the position which it had taken in December 1980 in support of retention and updating of Page 6.

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ATTACHMENT ONE-C

Minutes of the Meeting of the NAIC
Life, A&H Technical Staff Actuarial Group

Atlanta, Georgia
October 17 and 18, 1981

The NAIC Life, A&H Technical Staff Actuarial Group met from 9:00 a.m. until 5:00 p.m. on October 17, 1981 in the Flag Room of the Peachtree Plaza Hotel, Atlanta, Georgia, to consider certain topics pertaining to the NAIC (A) Life Committee.

The NAIC Group met again from 9:00 a.m. until 2:00 p.m. on October 18, 1981 in the same hotel room to consider the remaining topics pertaining to the NAIC (A) Life Insurance Committee and also topics pertaining to the NAIC (B) Accident and Health Insurance Committee.

The following persons from State Insurance Departments were present October 17:

Ted Becker (Texas); Douglas Broome (South Carolina); Bob Callahan (New York); Erma Edwards (Nevada); Edward Flickner, Jr. (Georgia); Storm Johnsen (Washington); Alan Lauer (Pennsylvania); John Montgomery (California).

The following persons from insurance companies, insurance associations and consulting actuaries were also present October 17:

Jack Adams, Executive Life Insurance Co.; Jim Allen, Federal Kemper Life Insurance Co.; Daniel F. Case, American Council of Life Insurance; Doug Close, Transamerica Occidental Life Ins. Co.; James Cowen, Society of Actuaries; Raymond Crapo, Consulting Actuary; Ann Enarson, Federal Kemper Life Insurance Co.; Alan Fougner, Transamerica Occidental Life Ins. Co.; Ardian Gill, American Academy of Actuaries; Jerome Golden, Monarch Resources, Inc.; Manny Halpern, Lone Star Life Insurance Co.; Burnett Halstead, Federal Kemper Life Insurance Co.; George Harding, University Life Insurance Co.; John H. Harding, National Life Insurance Co.; Norman Hill, Coopers & Lybrand; Dave Holland, Munich American Reassurance Co.; Peyton Huffman, ITT Life Insurance Corporation; Harold Ingraham, New England Life Insurance Co.; Robert J. Johansen, Metropolitan Life Insurance Co.; Richard Kischuk, Lincoln National Life Insurance Co.; Harold Leff, Metropolitan Life Insurance Co.; Robert Lowden, John Hancock Mutual Life Ins. Co.; Carl Ohman, Equitable Life Insurance Society; Anthony T. Spano, American Council of Life Insurance; Mike Tuohy, Tillinghast, Nelson & Warren, Inc.

The following persons from State Insurance Departments were present October 18:

Ted Becker (Texas); Douglas Broome (South Carolina); R. J. Callahan (New York); Erma Edwards (Nevada); Edward Flickner, Jr. (Georgia); Larry Gorski (Illinois); Storm Johnsen (Washington); Thomas J. Kelly (New York); J. Alan Lauer (Pennsylvania); John O. Montgomery (California).

The following persons from insurance companies, insurance associations, and consulting actuaries were also present October 18:

Tom Bickerstaff, Midatlantic Actuaries & Associates, Inc.; John K. Booth, American Council of Life Insurance; William Carroll, American Council of Life Insurance; Daniel F. Case, American Council of Life Insurance; Robert H. Dobson, Blue Cross & Blue Shield of Alabama; Harvey Galloway, Jr., Nationwide Life Insurance Co.; Manny Halpern, Lone State Life Insurance Co.; Bill Hezzelwood, Pacific Mutual Life Insurance Co.; Peyton Huffman, ITT Life Insurance Corporation; Bob Shapland, Mutual of Omaha Insurance Co.; Anthony T. Spano, American Council of Life Insurance; William Taylor, Massachusetts Mutual Life Insurance Co.; Peter Thexton, Health Insurance Association of America; Dave Trindle; Union Fidelity Life Insurance Co.; Chuck Underwood, Lyndon Insurance Co.

Life Insurance Committee Report

I. STANDARD VALUATION LAW AND STANDARD NONFORFEITURE LAW

A. The 1980 Model, Status of Enactment and Statutory Interest Rates

Mr. Anthony T. Spano reported on the progress of the 1980 NAIC amendments in the various states. The amendments had been enacted in 17 states. Mr. Spano said that this result compared favorably with progress of previous amendments, and that he expected continued success in 1982.

Mr. Robert J. Callahan reported on the status of these amendments in New York. A task force composed of various members of the New York Insurance Department and industry representatives had reached agreement on a bill which would enact the NAIC amendments in New York. Mr. Callahan said that the bill varied from the NAIC model in three ways:

1. Additional language was added which would give the superintendent authority to approve alternate mortality tables for use without prior NAIC approval in determining minimum standards for any specified class or classes of risks. This would enable the superintendent to address the problem of mortality standards for non-smoker and preferred risk policies.

2. Additional conditions were established for use of a valuation interest rate based on the formula which gives full weight to the reference interest rate. A company wishing to use these higher interest rates would be required to submit an opinion of a qualified actuary that the reserves for such annuities, benefits or contracts, and the assets held by the company in support of such reserves, make good and sufficient provision for the liabilities of the company with respect thereto. Also required would be a memorandum of the qualified actuary describing the calculations made in support of such opinion and the assumptions used in the calculations. For this purpose, a "qualified actuary" means any individual who is a member of the American Academy of Actuaries and satisfies the qualification standards set by the superintendent for practice in the valuation of life insurance company annual statement liabilities or who is designated a qualified actuary by the superintendent after written application to the superintendent providing evidence of such individual's actuarial knowledge and experience in the valuation of such liabilities. Finally, the calendar year statutory valuation interest rate for calendar years after 1995 would be determined by the formula for life insurance.

3. Language was added to require that the minimum aggregate test for the valuation of life insurance must be met separately for group, ordinary and industrial life insurance.

   Mr. John K. Booth said that a significant aspect of these changes was the movement toward more emphasis and reliance on the professional opinion of the actuary.

   Mr. Carl Ohman said that the American Academy of Actuaries published an exposure draft of a statement of Qualifications to Sign Statements of Actuarial Opinion on the NAIC Life and Accident and Health Annual Statement Blank. He said that he had provided the New York Insurance Department with a copy of the draft and that it was likely that New York would adopt these qualification standards.

   Mr. Ted Becker reported that Texas was one of the 17 states which had adopted the 1980 NAIC amendments. He also mentioned that the Texas Department was considering the adoption of mortality standards which would recognize differences in mortality between smokers and non-smokers for valuation of renewable term insurance.

   Mr. John O. Montgomery reported that the 1980 amendments had also been enacted in California. He said that there were some misprints in the bill which was passed, and that he hoped to have them corrected in 1982.

   Mr. Montgomery also mentioned that an article covering the changes in the valuation and nonforfeiture law would be featured in the November, 1981 issue of The Actuary. The article would be continued in a subsequent issue, and that issue would contain some tables showing the statutory calendar year interest rates based on the NAIC Standard Valuation and Nonforfeiture Laws. The Technical Staff Actuarial Group discussed the need to publish these rates. It was agreed that the tables of rates which had been included with the agenda would be attached to these minutes so that they would appear in the NAIC Proceedings. (See Attachment One-D).

B. Specifications for the Preparation of Actuarial Tables

Mr. Montgomery reported that he was serving as a member of a Society of Actuaries Committee which had been appointed to develop specifications for the calculation of monetary values based on the 1980 CSO Table. The committee had scheduled its first meeting for October 21, and hoped to complete its assignment within six months.

C. Problems in Interpretation

Mr. Montgomery introduced the subject of reserves for policies with cash values greater than reserves.

Mr. Callahan said that a company may set up the minimum reserve required by law plus the current excess, if any, of the cash value over that reserve. He said that the standard valuation law and the New York law permitted a company to use the minimum valuation standards of interest and mortality for the gross vs. net premium test required by the law. Mr. Callahan then described a reserve process which involves treating a policy as a partial endowment for the cash value at the end of each policy year.

Mr. Montgomery said that the solution should not be that complicated. He suggested that cash values could be regarded as benefits when the present value of benefits is determined, and that a guideline might be needed.

The Technical Actuarial Advisory Group deferred action on the matter.

D. Updating or Replacing Existing Policies

Mr. Spano gave an oral summary of the comments which had been received from the ACLI Actuarial Committee. The commentators had generally agreed that updating programs would benefit the policyholders and, therefore, any regulation of them should be designed to encourage companies to undertake such programs. Mr. Spano said that additional work was needed before a report could be prepared, but that he hoped to have a report by the spring 1982 meeting. He mentioned definitions of an update program and conditions for a unilateral program as examples of two areas where additional work was needed.

Mr. Broome questioned whether any unilateral change could be made by an insurer.

Mr. Spano cited an example of a change under which the policyholders would clearly benefit.

Mr. Callahan said that the New York Insurance Department was considering a proposal which involved a negative enrollment approach. He mentioned that New York had allowed unilateral changes of industrial insurance policies because of the cost of contacting all policyholders.

E. Other Matters

1. Valuation-Nonforfeiture Interest Rate Differentials - Mr. William Carroll distributed a report, dated October 15, 1981, and gave an oral summary of the major findings of the report. The report had been prepared in response to a request of the former (C4) Technical Subcommittee for an opinion on certain questions which arise when reserves and cash values are calculated at different interest rates. The first three findings dealt with the legal criteria for interest rates used to calculate basic policy cash values, amounts of paid-up nonforfeiture benefits, and cash surrender values of paid-up nonforfeiture benefits. The fourth finding was that the interest rate used in determining the minimum standard for the valuation of paid-up nonforfeiture benefits shall be the rate specified in the valuation law for other than single premium policies. The fifth finding dealt with the contingency that the valuation and nonforfeiture bases could be such that there were some future durations at which reserves for a policy in a premium-paying status were less than the reserves which would be required if the policy were continued under a paid-up nonforfeiture benefit. The report concluded that the potential strain need not be prefunded. Mr. Carroll said that this finding was consistent with the commissioners reserve valuation method which in the standard law is written in terms of a single decrement reserve requirement. The final finding dealt with paid-up dividend additions.

   Mr. Carroll stressed the point that the report presented these findings as straightforward interpretations of the current standard laws, intended as a short summary of the main thrust of the law and not intended as a substitute for a careful reading of the law. He also pointed out that the findings did not apply to products such as universal life which may be of such a nature that the minimum values cannot be determined by the methods discussed in the standard laws.

   In response to a question from Mr. Montgomery, Mr. Carroll said that the council had concluded that the standard laws are clear with regard to the use of interest rates for reserves and nonforfeiture values and that no additional amendments or interpretive guidelines are needed.

   Mr. Callahan went over an example dealing with the purchase and surrender of reduced paid-up insurance.

   Mr. Ardian Gill asked why the report referred to a distinction in the valuation interest rate between single premium insurance and other insurance, and why the report concluded that the interest rate used to determine the minimum reserve for paid-up nonforfeiture benefits should be the rate for other than single premium life insurance.

   Mr. Carroll said that, although the 1980 amendments eliminated the interest rate distinction between single premium and other life insurance, the distinction continues to apply to policies sold under the prior standard. He added that the higher interest rate permitted prior to the 1980 amendments for single premium policies is not appropriate for paid-up nonforfeiture benefits since those policies issued in a given year which are eventually continued on a paid-up nonforfeiture status are continued at various times over several years following the issue of the policies and the establishment of the valuation standards.

The Technical Staff Actuarial Group received the report and planned to discuss it further at its next meeting.

2. Operative Date of 1980 Amendments for Life Insurance - Mr. Montgomery asked if a company should be permitted to comply with the 1980 amendments on a plan-by-plan basis.

Mr. Becker said that, in the past, Texas had required that insurers must move to the new mortality table on an entire portfolio basis. He added that the Texas department was currently studying the question.

Mr. Spano said that the law was written in terms of minimum standards and that a plan-by-plan approach might be possible.

Mr. Carroll said that even if it were held that the law requires a single operative date after which all policies must comply, an insurer should still be permitted to demonstrate that a previously approved plan complies. He pointed out that the operative date clause was one intended to ease the transition to the new standards, and, therefore, it should be interpreted liberally.

Mr. Broome said that South Carolina planned to permit a plan-by-plan transition.

Mr. Montgomery said that it would be difficult to show that older policies met the new standards. He felt that reduced paid-up insurance could be a problem, especially for policies sold to women and older persons.

The group took no action on the question.

3. Valuation of Active Life Funds Held Under Group Annuity Contracts - Mr. Becker mentioned that the group needed to recommend an interest rate for the valuation of 1981 contributions to these funds. He said that the rates used in the past had followed those developed by the New York Insurance Department.

Mr. Ohman said that the New York Department had not yet decided on the 1981 rate. He reviewed the history of the New York circular letter. For four or five years each year's rate had been based on the industry average new money rate for the prior year. This had worked well until interest rates began to move rapidly from year to year. In 1980 the industry had asked New York to base the valuation interest rate on an estimate of the 1980 new money rate rather than on the actual 1979 new money rate. The valuation interest rate of 9.5% for 1980 contributions contained in the New York circular letter and published in the NAIC guideline was mid-way between the 10.0% figure which would have resulted if the 1980 estimate had been used and the 9.0% rate based on 1979 investments.

Mr. Callahan pointed out that the 9.5% rate had been obtained from the 1980 new money average by giving only half weight to the portion of the average in excess of 10%. He said that the industry study had been completed by New York, but that a final decision had not been reached. He said that the industry new money average for 1981 was estimated at 13.421% which would result in a valuation rate for 1981 contributions of 12.4% if full credit were given, and 10.7% if the 50% reduction were applied to the excess over 10%. He also said that the study showed that the 1980 valuation rate would have been 10.0% based on actual results without reduction.

Mr. Ohman recommended that the group adopt a valuation interest rate of 12.4% for 1981 contributions and that they revise the rate for 1980 contributions to 10%. He said that these rates would result in reserves comparable to the reserves which would result from application of the 1980 amendments to the standard valuation law for a company with a typical mix of this kind of business.

Mr. Booth supported this recommendation.

The group voted to accept these figures of 12.4% for 1981 contributions and 10.0% for 1980 contributions.

Mr. Montgomery said that some thought should be given to the question of how the interest rate for the guidelines should be established if New York passes the 1980 amendments and discontinues its study.

II. MINIMUM SURPLUS

A. Report of the Committee on Dynamic Interest and Related Matters

Mr. Ohman reported for the advisory committee. He outlined the activity of the advisory committee since it last reported to the Technical Staff Actuarial Group in Detroit. Its Subcommittee on Surplus and Solvency had met and its other subcommittee members had communicated by mail. The advisory committee had scheduled a meeting for early December in Phoenix and Charles Greeley planned to report to the Technical Staff Actuarial Group at its meeting in New Orleans.

B. Wisconsin Legislation and Regulation

Mr. Spano reported that a committee was working to develop a regulation which would establish minimum surplus required by Wisconsin. The commissioner had appointed the committee to implement a law which required the commissioner to establish minimum surplus requirements. Mr. Spano said that following each of the two or three drafts which had been exposed there had been a number of negative comments. Some had dealt with the details of the proposal, but the more serious ones questioned whether the type of rules being considered were appropriate. Mr. Spano suggested that the work of the Society of Actuaries task force which is studying the (C3) risk should be completed before serious considerations of surplus needs is undertaken.

Mr. Montgomery agreed that the Wisconsin work was premature.

Mr. Booth said that the Wisconsin position seemed to be moving in the opposite direction from that being taken by the (C3) Risk Task Force. In its work, the task force has been stressing the need to test the assets supporting a block of business under a range of assumptions and to place more reliance on the judgment of the actuary. The task force has always warned of the danger of simple rules-of-thumb, such as are being proposed by Wisconsin.

C. Elements of a Law Defining Minimum Surplus According to the Structure of the Risk Assumed by an Insurer

Mr. Ohman reviewed the history which had led to the appointment of the (C3) Risk Task Force by the Society of Actuaries. The Trowbridge Society Committee had classified the risks to which insurers were exposed, and the Greeley advisory committee had urged that additional work be done. The (C3) Risk Task Force had been appointed to study the risks associated with fluctuations in the level of prevailing interest rates. Other plans will be made to study the risk of asset default and the risk of premium inadequacy.

Mr. Ohman summarized the progress of the (C3) Risk Task Force. A report was planned for the Atlanta meeting of the Society of Actuaries. Three papers would be discussed. Mr. Ohman's paper, which he distributed, reported the progress and plans of the task force. A paper by James Tilley presented illustrative calculations for guaranteed interest contracts, and Donald Cody's paper covered some of the mathematical background.

Mr. Ohman said that the task force would present a full report at the Houston meeting of the society in April, 1982. He said that calculations for nonparticipating whole life would be available by then. Plans were also being made to analyze participating whole life, universal life, and deferred annuities. After that there were a number of possible activities - more research could be done, educational activities could be expanded, and a new framework for the valuation of a life insurance company, taking into account both assets and liabilities, could be developed. Mr. Ohman said that the American Academy of Actuaries' interpretation for the actuarial opinion could be revised. He explained that the problem with the current interpretation, which is now 10 years old, was with the tone rather than the content. The problem is that the current interpretation implies that in most cases the actuary can determine whether the reserves do make good and sufficient provision by just a rather quick look.

Mr. Ohman concluded his presentation with the comment that the tests that New York plans to require in connection with the valuation of guaranteed interest contracts represent a very important step forward in this subject.

Mr. Ed Flickner commented that some actuaries make a specific disclaimer as to asset values in their opinions as to reserves.

Mr. Ohman urged that the Technical Staff Actuarial Group not proceed too rapidly. He said that the necessary research should be conducted and that the appropriate committee of the American Academy of Actuaries should become involved. He also mentioned that the Greeley Advisory Committee had a subcommittee, chaired by Walter Rugland, which could be expected to persue the subject.

III. FUNDED PLANS OF LIFE INSURANCE (UNIVERSAL LIFE) AND ANNUITIES (LATER CHANGED TO UNIVERSAL LIFE AND RELATED PLANS OF LIFE INSURANCE AND ANNUITIES)

A. General Features

The Technical Staff Actuarial Group discussed the appropriateness of the name given to this topic on the agenda. Other names considereed were: "Universal Life and Indeterminate Premium Plans," or "Adjustable Life Policies." It was decided to use the title "Universal Life and Related Deferred Annuities." Mr. Montgomery suggested that the words, "Plans valued on a retrospective basis," could be added.

B. Interest Indexed Plans

The group considered universal life in general and in its discussion did not usually distinguish between those universal life plans where the interest rate credited was related to an external index and the more traditional universal life plans.

C. Reporting Requirements and Regulations

In December 1980 the NAIC Technical Staff Actuarial Group (formerly the NAIC Life, Accident and Health Insurance (C4) Technical Subcommittee) had asked the American Council of Life Insurance to develop proposed valuation and nonforfeiture requirements for universal life insurance policies, adjustable-premium policies, and single-premium adjustable death benefit policies. Since the Standard Valuation and Nonforfeiture Laws do not directly address plans of those types, the NAIC's 1980 model amendments of the Standard Laws included a provision stating that valuation and nonforfeiture requirements for such policies may be determined by regulations promulgated by the insurance commissioner.

Mr. Daniel Case reported that a task force of the ACLI was charged with developing a response to the request of the NAIC Technical Staff Actuarial Group. He said that that task force, working through an actuarial subgroup, had developed some tentative valuation and nonforfeiture concepts for universal life insurance. (The actuarial subgroup had decided to concentrate on universal life insurance because it anticipated that the standards which might be adopted for it could be adapted for other products.) During the course of the work, however, it became evident that the universal-life-type products are in too early a stage of their development to warrant the adoption of firm valuation and nonforfeiture requirements at this time. Such requirements might fail to take into account certain varieties of product which are now on the drawing boards or soon may be developed, Mr. Case said.

Mr. Montgomery agreed with the suggestion that valuation and nonforfeiture requirements not be adopted at this time.

Mr. Case continued his report by describing the valuation and nonforfeiture concepts which the ACLI Task Force had tentatively developed for universal life insurance. The following is an explanation, as presented by Mr. Case, of the concepts which are embodied in the material:

Universal life policies involve a running account, to which premiums (after deduction of certain expense charges) and interest are credited and from which mortality charges and other expense charges are deducted. The account value is redetermined periodically (typically, once a month). The cash surrender value at any time may be equal to the account value, or it may be different from the account value, as specified in the policy.

> Reserves - The major portion of the contemplated required reserve is that denoted as component (A) in the written material. Component (A) consists primarily of the present value of the future benefits which the account value will provide if all future credits and charges are made on the bases which have been guaranteed in the policy.
>
> Since the policy normally does not contain mortality and interest guarantees which are more favorable than those contained in the minimum reserve standard specified in the Standard Valuation Law for life insurance policies generally, this present value, computed as specified, would normally equal the account value itself.

If the company declares additional interest (over and above the rate guaranteed in the policy) for a year or two in advance, that guarantee would raise the component (A) reserve somewhat above the account value. If the policy calls for planned future premiums, they would also be reflected in component (A) of the required reserve. If, however, the policy guarantees attached to those premiums are no more favorable than the mortality and interest standards specified in the Standard Valuation Law, the planned future premiums would have little or no effect on the required reserve.

The (B) component of the contemplated required reserve is designed to place the minimum reserve standard on a basis comparable to the Commissioners Reserve Valuation Method for traditional policies. Here it may first be noted that under many universal life policies the first-year expense charges are larger than the expense charges imposed in renewal years. As a result, the policy account builds more slowly in the first policy year, for a given amount of premiums, than it does in renewal years. Accordingly, if gross premiums are actually paid levelly over the entire premium-paying period and the amount of insurance is level, a reserve which equaled the account value at every duration would be in effect, a modified reserve rather than a net level reserve. Even though the premiums actually paid under most universal life policies, and the amounts of death benefit coverage actually provided, may not be level, we may think of the (A) component as constituting a modified reserve. The (B) component, then, would adjust that modified reserve, if necessary, to another modified reserve which is analogous to the CRVM reserve.

To make this adjustment it is necessary to compare the additional first-year expense charge (item (I) in component (B)) with the additional first-year reserve allowance that is provided by law, under the Commissioners Reserve Valuation Method, for a roughly comparable traditional policy. For a universal life policy with relatively little additional first-year expense charge, component (B) would result in a deduction from the reserve called for by component (A).

The (C) component is intended to make a further adjustment as may be necessary after the amount of insurance is changed at the policyholder's request.

Nonforfeiture Value - The contemplated minimum cash surrender value requirement is based on a retrospective approach, since future premiums are not known. The approach relates the minimum values to the policy account which is being accumulated for the purposes of providing benefits under continuing policies. As in the Standard Nonforfeiture Law provisions for traditional products, there is a limit on the excess of initial expense charges over renewal expense charges. The intent is to achieve equity between continuing and surrendering policyowners, rather than to require minimum levels of cash surrender benefits as such.

The contemplated minimum cash surrender value requirement involves an accumulation of "universal life adjusted premiums", which are defined as percentages of the premiums paid, after deduction of premium collection charges. The percentages are based on what the policy states will be deducted from premiums in policy years two through twenty in determining the account value (which may or may not be equal to the cash surrender value).

From the above-mentioned accumulation of "universal life adjusted premiums" would be deducted accumulations of the mortality charges and other expense charges imposed under the policy, including acquisition expense charges not exceeding the initial expense allowance. The accumulations would be at the interest rates actually credited unconditionally to the account. That is, the company could declare, for example, that of the total interest of 10% to be credited in policy year 1983-4, 6% was conditional on the policy's not being surrendered within the next three policy years. This feature would make possible a "surrender charge" in the form of a withholding from surrendering policyholders of portion of the interest which was being (had been) credited to persisting policyholders.

A second source of permissible "surrender charge" would arise from the excess, if any, of the initial expense allowance over the acquisition expense charges actually made. The initial expense allowance would be set at the amount of allowance provided by the Standard Nonforfeiture Law for a roughly comparable traditional policy. The amount of the "unused" initial expense allowance would be amortized over the premium-paying period, resulting in a "surrender charge" which disappeared by the end of that period. Additional "unused" allowances might arise if the policyowner requested an increase in the face amount.

The section titled, "Actual Cash Surrender Values", while complicated in its wording, is intended merely to impose a cash-value grading requirement analogous to what is in the latest version of the Law for traditional policies. It would require that during the five years leading up to the maturity date the actual cash values grade up to the maturity value, and that the actual cash values in earlier years also grade smoothly over periods of at least five years each.

When he finished his oral remarks, Mr. Case distributed copies of some written material entitled, "Universal Life" Valuation and Nonforfeiture Concepts, which was dated October 17, 1981. Again, he reminded the group that the material was not in finished form, that the concepts were still under discussion, and that it would be inadvisable to promulgate reserve and nonforfeiture requirements in the immediate future.

Mr. Montgomery had included with his mailing of September 24 a discussion draft of a proposed California bulletin on Funded Plans of Life Insurance and Annuities. He had received several letters in response to this exposure and he reviewed each of them for the Technical Staff Actuarial Group. The following is a summary of each of the letters:

1. William J. Adams, Executive Life, October 13. Mr. Adams objected to the use of the term "funded" in the title of the bulletin. He also objected to requiring standards and tests of solvency for this plan different from those required of other plans.

2. Wilbur M. Bolton, Transamerica Occidental Life, October 2. Mr. Bolton suggested that it would be unnecessary for a company to set up an interest guarantee reserve on the portion of reserve which is offset by policy loans as long as the interest rate credited on that portion was less than the policy loan interest rate. He asked for an opinion.

3. Alan T. Cunningham, Transamerica Occidental Life, October 9. Mr. Cunningham complimented Mr. Montgomery on his fine effort in attempting to achieve a balance between regulatory and industry concerns. He made some technical comments concerning terminology, reports, and requirements for indexed plans.

4. Jerome S. Golden, Monarch Resources, Inc., October 9. Mr. Golden's letter contained several helpful comments and concluded that the subject needs greater study before a definitive regulation can be issued.

5. Ronald J. Helow, First Penn-Pacific, October 8. Mr. Helow addressed his comments to three major sections of the Discussion Draft - special requirements for funded plans, disclosure, and reports to the insurance department. His letter generally favored flexibility and opposed special requirements for funded plans.

6. Storm Johnsen, Washington Department of Insurance, October 7. Mr. Johnsen said that the California draft seemed to concentrate on the mortality and interest experience only. He said that some companies included persistency expenses, and other factors. He stressed that the contract should identify all the actuarial assumptions by which the company may vary its premiums, face amounts of insurance, and duration of contracts.

7. Thomas G. Kabele, Guardian Life, September 21. Mr. Kabele objected strongly to the words used in the discussion draft to explain the difference in the way interest is credited on universal life and on traditional variable life and variable annuity products. He provided alternate wording which would correct the problem and also enclosed some additional disclosure requirements for Mr. Montgomery's consideration.

8. J. Alan Lauer, Pennsylvania Insurance Department, September 23. Mr. Lauer sent Mr. Montgomery a copy of the Pennsylvania filing guidelines for universal life contracts. He noted that they had decided on guidelines, not regulations, because guidelines could be more easily promulgated, many questions were as yet unanswered, and guidelines could be more easily changed.

9. W. Keith Sloan, Kentucky Department of Insurance, September 25. Mr. Sloan made several technical comments. He said that he planned to make a similar recommendation in Kentucky. He pointed out some places where he thought Kentucky should vary.

10. Michael R. Tuohy, Tillinghast, Nelson & Warren, Inc. October 3. Mr. Touhy said that guidelines with regard to the matching of assets and liabilities of a life company are long overdue. He said that the company actuary should have the responsibility of ensuring that his company's investment strategy satisfactorily matches the policyholder's liabilities, and that if the actuary cannot be given this responsibility, then insurance departments must institute reporting systems that allow them continuously to check the relationship between assets and liabilities. In addition to these broad comments, Mr. Tuohy made several detailed technical comments.

11. William A. White, New Jersey Department of Insurance, September 21. Mr. White's letter was addressed to Mr. Lauer with a copy to Mr. Montgomery. In it he compared the Pennsylvania guidelines with the California exposure draft. He noted that the California draft tends to concentrate more on the technical actuarial aspects of these contracts (valuation, nonforfeiture, assets, and surplus requirements) whereas his inclination is to stress the consumer and marketing (policy forms, disclosure, replacement problems, and pricing variable changes) potential abuses. He concluded that both treatments were essential and can comfortably complement one another.

Following a lively discussion of these comments, Mr. Montgomery said that careful consideration would be given to each of the comments and that he hoped that a revised draft would be available for discussion at the Los Angeles Actuarial Club meeting on December 7.

D. Distinguishing Features as Compared to Variable Life Insurance and Variable Annuities

Mr. Jerome Golden pointed out that the essential feature which distinguishes these products from other products is the fact that the assets supporting the product are invested in a separate account, protected from claims of the general account, and that benefits and/or structure of these products depend directly on the performance of the separate account.

E. Other Matters

Mr. Ardian Gill reported that his academy committee was studying valuation and nonforfeiture criteria for these products.

IV. VARIABLE LIFE AND VARIABLE ANNUITIES

A. Report of the Advisory Committee on Revisions in Legislation and Regulation Required by Enactment of 1980 Model Valuation and Nonforfeiture Laws

Mr. Golden distributed a letter dated October 15, 1981 and attachments which contained the advisory committee's general recommendations for revisions to the NAIC Model Variable Life Insurance Regulation. The letter suggested that the Technical Staff Actuarial Group ought to consider four points in evaluating the recommendations:

1. Variable Life Insurance has been sold for more than five years with nearly $5 billion of face amount already issued.

2. Except for any minimum death benefit guarantee, the insurance company issuing VLI does not assume an investment risk.

3. Under the NAIC Model Variable Contract law, the assets of the separate account liabilities are protected from claims of the general account.

4. There is considerable regulation of VLI at both the NASD and SEC levels.

The advisory committee categorized two basic types of VLI covered by the regulation into "scheduled premium" and "flexible premium."

Because of the large volume of material, Mr. Golden suggested that the advisory committee would be available to meet separately with all or some of the members of the NAIC Technical Staff Actuarial Group.

Mr. Becker suggested that this might be possible in New Orleans at the December NAIC meeting.

B. Other Matters

There was no other discussion of this agenda item.

V. MORTALITY AND MORBIDITY STUDIES

A. Super Select Mortality, Smoker vs. Non-Smoker

Mr. Becker reported that the Texas Department was considering the adoption of mortality standards which would recognize differences in mortality between smokers and non-smokers for valuation of renewable term insurance.

Mr. Montgomery said that universal life and indeterminate premium life insurance represented ways to solve deficiency reserve problems.

Mr. Lauer said that if lower mortality standards were permitted for non-smoker policies, then higher mortality standards would be appropriate for policies insuring smokers.

Mr. Leff said that while this might be true theoretically, it might not be needed in practice. Because of the improvements in mortality since the 1980 CSO exposure period, that table might be suitable for smokers.

Mr. Leff also said that the Greeley Advisory Committee planned to discuss this subject at its next meeting and report at the December meeting of the NAIC Technical Staff Actuarial Group.

B. Society of Actuaries

1. Individual Annuities. Mr. Robert J. Johansen reported that the Committee to Recommend a New Mortality Basis for Individual Annuity Valuation had developed a mortality table which was designed for valuation of individual annuities, the 1983 Table "a" An exposure draft of the Committee's report had already been distributed to the members of the Society for discussion at the 1981 annual meeting.

   Mr. Montgomery said that the new table could be presented to the NAIC for exposure at its December, 1981 meeting and adopted at the June, 1982 meeting. He thanked Mr. Johansen, chairman of the committee which developed the table, for the fine work.

   Mr. Leff said that the Advisory Committee on Dynamic Interest and Related Matters would review the report and give the group its comments at the December meeting.

2. Group Annuities. Mr. Leff said that the Greeley Committee planned to include some comments on group annuity mortality in its December, 1981 report.

3. Disability Experience for Disability Benefits Attached to Life Insurance Policies. Mr. Becker reported that he and Mr. William Taylor had discussed the need for a study of disability experience under benefits attached to life insurance policies. Mr. Becker said that Mr. Taylor did not know if his committee would be able to undertake this study after it finished its work on disability insurance.

   Mr. Montgomery pointed out the need for an updated reserve basis for this business. He said that a number of companies still write it.

4. Substandard Insurance. There was no discussion of this topic.

5. Credit Life and Credit Disability. Mr. Chuck Underwood reported on the progress of the Pilot Study. The Society of Actuaries Committee had had problems with the data for one of the three companies in the pilot group. He said that the group planned to meet on October 18 in the same hotel as the NAIC Technical Staff Actuarial Group, and he invited the members of the group to attend.

6. Other. There were no other topics to discuss under this agenda item.

VI. OTHER SPECIAL PLANS

A. Indeterminate Premium Plans

Mr. Becker mentioned a proposal by the staff to amend the Texas regulation on indeterminate premium policies. The proposal would provide that minimum reserves and minimum nonforfeiture values would not be less than those defined by substituting any illustrated premiums for actual gross premiums. Thus, if a company illustrated level gross premiums, its minimum reserves and nonforfeiture values would have to be large enough for a level premium policy. (This would apply to the minimum basic reserves, but the illustrated premiums would not affect deficiency-type reserves.)

Mr. Douglas Broome mentioned a level annual premium policy where the death benefit rather than the premium varies. He said it could be described as an "indeterminate death benefit" plan.

B. Single Premium, Specified Minimum Death Benefit Life Insurance Plans

There was no discussion of this topic.

C. Other Plans

There were no other plans discussed under this topic.

VII. REORGANIZATION OF THE ACTUARIAL TASK FORCE CHARGE, AND VIII. REPORT TO THE (A) LIFE COMMITTEE

Discussion of these two agenda items was deferred to executive session.

IX. OTHER MATTERS

A. Revision of Analysis of Increase in Reserves

There was no discussion of this topic.

B. Reserve Strengthening for Insurers Earning Less on Their Investments Than Guaranteed in Their Reserve Accumulation and Deposit Fund Guarantees

It was noted that this agenda item falls within the scope of agenda item II, minimum surplus.

C. Special Interest Section in Society of Actuaries and Formation of a Society of Government Actuaries

Mr. Montgomery reported that he had been unable to find ten fellows of the Society of Actuaries willing to join in forming a special interest section.

D. Other

There was no other business to discuss.

Accident and Health Insurance Committee Report

I. NAIC PREMIUM RATE FILING GUIDELINES

Mr. John O. Montgomery distributed copies of two letters from Paul Barnhart dated October 16, 1981. One of these related to the April 1981 revised draft of "Guidelines for Filing of Rates for Individual Health Insurance Forms", as submitted by the H.I.A.A. Mr. Barnhart's letter requested that further study be given to the proposed revisions before any action is recommended to the NAIC. He questioned two sections of the proposed revisions. First, in the proposed footnote to section II.B, the modified opening paragraph called for double and potentially conflicting standards. It required that the "following loss ratios meet the standards in II.A and in the predecessor regulation as applicable for the period in which the premium is earned." Second, the proposed footnote modification also referred to predecessor regulations which included "past premium and loss experience" in a rating formula. In this connection, the draft seemed to be implying that "retroactivity" should only apply under a regulation that specifically calls for inclusion of past experience. Mr. Barnhart disagreed with this implication.

Neither Mr. Barnhart nor Mr. Peter Thexton were present, and the Technical Staff Actuarial Group proceeded with a general discussion of retroactivity.

Mr. Robert Shapland objected to any requirement that would force a company to set aside gains from favorable experience on a form and prevent these gains from being used to offset losses on other forms. Where this has been legitamitely done, it should not be undone retroactively.

Mr. Montgomery emphasized that policy forms of the same generic type could be combined for experience rating purposes.

Mr. Shapland admitted that this would work in some cases, but he cited several examples where it would not work.

Mr. Storm Johnsen suggested a committee be appointed to study the entire subject. He noted that the state of Washington is within two or three weeks of releasing a revised discussion draft, and a regualtion there should be effective no later than January 1982.

Mr. Montgomery said that there were several committees already working on this subject and another was not necessary.

Mr. Thexton arrived and commented on Mr. Barnhart's letter. Mr. Thexton expressed some sympathy for Mr. Barnhart's first point but pointed out that an alternate solution had not been suggested. He said that the HIAA would have to consider the second point and that a difference of opinion was likely. Mr. Thexton expressed a strong desire that the next set of changes to this regulation be the final set.

Mr. Montgomery urged Mr. Thexton to put together a response as soon as possible so that a final version could be exposed at the December 1981 meeting and adopted in June 1982.

Mr. Thexton said that he would try to get an answer by early November.

Mr. Montgomery introduced the subject of major medical policies with benefits and premiums related to the consumer price index.

Mr. William Hezzelwood discussed the rationale behind such a product. A key ingredient is that the deductible also increase. Mr. Hezzelwood noted that the product was only in the planning stages, but that the current premium rate filing guidelines would not allow it.

After considerable discussion the Technical Staff Actuarial Group voted to entertain a recommendation that the guidelines be changed to permit such an indexed policy.

II. EXPERIENCE TABLES

A. Disability - Society of Actuaries Study

Mr. William Taylor reported on the recent progress of the committee which he chairs. The committee has reduced the number of variables which need study and has solved some of the major problems which had been holding up progress. The log-linear method had not provided a good graduation of the data and an n-dimensional Whittaker-Henderson formula was developed. Progress was being made on both the incidence and continuation of disability. The next meeting was scheduled for December 9.

Mr. Montgomery complimented the society committee on the sophistication of its work. He said it would be a landmark in the handling of functions of several variables. He mentioned that the Society of Actuaries would have to appoint another committee to define the specifications for use of the new disability table.

Mr. William Carroll pointed out that the log-linear method was also important in determining which variables were significant.

Mr. Thexton asked if the society committee report would conclude that sex as an important variable in disability income insurance. Mr. Taylor responded affirmatively.

Mr. Shapland and Mr. Larry Gorski raised questions regarding the use of these tables.

Mr. Montgomery said that the tables would be useful in determining whether reserves were adequate.

There was considerable disagreement with this opinion and a long discussion of whether companies should hold the larger of the unearned premium reserve and the reserve based on those tables.

B. Cancer and Dread Diseases

Mr. Montgomery read a letter from William Odell of the Technical Advisory Committee dated October 14 which gave a brief summary of progress. Data had been submitted by 17 companies, representing 85% of the cancer insurance sold in the United States. The committee hoped for completion of the study by spring 1982.

III. VALUATION

Mr. Shapland said that he had received permission from the Society of Actuaries to expose his report. It was to be discussed at a Society meeting later in the week. The report was identical to the draft previously distributed to the NAIC Technical Staff Actuarial Group.

IV. NONFORFEITURE BENEFITS

Mr. Ted Becker reported that Mr. Ernie Frankovich had been asked to reappoint and reorganize the advisory commitee on this subject. Mr. Frankovich felt that he should postpone this until the NAIC Technical Staff Actuarial Group was reappointed.

Mr. Tom Bickerstaff mentioned a specific problem he had encountered in the course of his work for Delaware. The group decided not to consider the problem as a group. Mr. Bickerstaff was advised that he could seek the opinion of any of the members as individuals.

V. HOSPITAL AND MEDICAL CORPORATIONS

Mr. Robert H. Dobson, Chairman of the Technical Advisory Committee on Hospital and Medical Corporations, requested that the Technical Staff Actuarial Group take an official position on the advisory committee report.

The NAIC Technical Staff Actuarial Group agreed to adopt the advisory committee report. It was noted that the report constituted more of a framework than a specific solution for problems. Mr. Dobson was also officially asked to continue work on the project of advising how the report might be implemented at the state level.

The final report of the advisory committee had called for an opinion of a qualified actuary and the American Academy of Actuaries had been asked to develop wording for such an opinion Mr. Barnhart had submitted a memorandum, dated October 16, 1981, regarding "Proposed Actuarial Opinion Instructions for Health Service Corporations and Health Maintenance Organizations."

The NAIC Technical Staff Actuarial Group adopted Mr. Barnhart's memorandum.

VI. SEX DISCRIMINATION STATEMENT

It was noted that the NAIC had not taken action on the statement submitted by the former (C4) Technical Subcommittee at the June, 1981 meeting. The NAIC Technical Staff Actuarial Group agreed to resubmit the statement at the December, 1981 meeting.

VII. OTHER MATTERS

See the Life Insurance Committee Report, agenda item IX, for a discussion of these topics.

EXECUTIVE SESSION

The Life, A&H Technical Staff Actuarial Group met in a brief executive session on Sunday, October 18, 1981, immediately following the meeting in open session to consider the two topics "Reorganization of Actuarial Task Force Charge" and "Report to the (A) Life Insurance Committee." (These two topics were listed under the agenda for the (A) Life Insurance Committee, but they also pertain to the (B) Accident and Health Committee.)

<u>Reorganization of Actuarial Task Force Charge</u>

This topic had been deferred at the meeting in open session on October 17, 1981.

After discussion, it was agreed that the Life, A&H Technical Staff Actuarial Group should divide itself into subgroups which would work on the uncompleted actuarial projects that were still pending.

There would be five subgroups which were concerned with life insurance topics:

1. Standard Valuation Law and Standard Nonforfeiture Law for Life Insurance, along with actuarial guidelines
2. Minimum surplus
3. Special plans
4. Experience tables
5. Credit Life and credit disability

There would also be five subgroups which were concerned with accident and health topics:

1. Rate filing guidelines and statutory valuation
2. Hospital and medical corporations
3. Nonforfeiture benefits
4. Experience tables
5. New plans and other topics

Each individual who is active in the Life, A&H Technical Staff Actuarial Group would be assigned to several of these subgroups; depending on his or her interests.

It was agreed that further consideration to this concept of subgroups would be given at the next meeting of the Life, A&H Technical Staff Actuarial Group in December 1981. This December 1981 meeting is to be held in connection with the NAIC Winter Annual Meeting in New Orleans, Louisiana.

It was also agreed that, in general, the Life, A&H Technical Staff Actuarial Group should reserve its energies for a reasonable number of important long-term projects.

It was noted that apparently no one in the NAIC Support and Services Office was working on organizing the written reports of the previous (C4) Life, Accident and Health Insurance Technical Subcommittee.

It was also noted that state insurance department actuaries from certain other states might wish to be active in the Life, A&H Technical Staff Actuarial Group in the future, even though these states were not represented at the October 1981 meeting.

Report to the (A) Life Insurance Committee

After discussion, it was agreed the report of the Life, A&H Technical Staff Actuarial Group should include a synopsis, an outline of the projects it is working on, and a notice of its meetings. The report would close with the recommendations to the (A) Life Insurance Subcommittee.

The report to the (B) Accident and Health Committee was not discussed separately, but presumably it would be developed in the same manner. Of course, it would close with recommendations appropriate for that committee.

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ATTACHMENT ONE-D

STATUTORY CALENDAR YEAR INTEREST RATES
BASED ON NAIC STANDARD VALUATION AND NONFORFEITURE LAWS
(Rates are for 1981 business except where otherwise indicated)

A. Life Insurance Valuation and Nonforfeiture Interest Rates

Guarantee Duration (years)	Valuation Interest Rate		Nonforfeiture Interest Rate	
	1981	1982	1981	1982
10 or less	6.00%	6.75%	7.50%	8.50%
More than 10, but not more than 20	5.75	6.25	7.25	7.75
More than 20	5.00	5.50	6.25	7.00

B. Single premium immediate annuities, and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

Valuation interest rate – 11.50

C. Valuation Interest Rates for Other Annuities and Guaranteed Interest Contracts:

Contracts Valued on Issue Year Basis

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type* A	B	C
Yes	Yes	5 or less	11.50%	9.50%	8.25%
		More than 5, but not more than 10	11.00	9.50	8.25
		More than 10, but not more than 20	7.75	6.75	6.25
		More than 20	6.25	5.50	5.50
Yes	No	5 or less	12.00%	10.00%	9.00%
		More than 5, but not more than 10	11.50	10.00	9.00
		More than 10, but not more than 20	8.00	7.00	6.75
		More than 20	6.75	6.00	6.00
No	Yes or No	5 or less	11.50%		
		More than 5, but not more than 10	11.00	NOT APPLICABLE	
		More than 10, but not more than 20	10.00		
		More than 20	7.75		

D. Valuation Interest Rates for Other Annuities and Guaranteed Interest Contracts:

Contracts Valued on Change in Fund Basis
(Only contracts with cash settlement options may be valued on change in fund basis)

Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type* A	B	C
Yes	Yes	5 or less	13.25%	12.00%	9.00%
		More than 5, but not more than 10	12.75	12.00	9.00
		More than 10, but not more than 20	11.50	11.00	8.25
		More than 20	9.50	9.50	7.25
Yes	No	5 or less	13.75%	12.75%	9.50%
		More than 5, but not more than 10	13.25	12.75	9.50
		More than 10, but not more than 20	12.00	11.50	9.00
		More than 20	10.00	10.00	7.75

* See next page for description of plan types

* Plan Type A	At any time policyholder may withdraw funds only (1) with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) without such adjustment but in installments over five years or more, or (3) as an immediate life annuity, or (4) no withdrawal permitted.
Plan Type B	Before expiration of the interest rate guarantee, policyholder may withdraw funds only (1) with adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) without such adjustment but in installments over five years or more, or (3) no withdrawal permitted. At the end of interest rate guarantee, funds may be withdrawn without such adjustment in a single sum or installments over less than five years.
Plan Type C	Policyholder may withdraw funds before expiration of interest rate guarantee in a single sum or installments over less than five years either (1) without adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) subject only to a fixed surrender charge stipulated in the contract as a percentage of the fund.

Table of Statutory Calendar Year Interest Rates

(a) Life Insurance $I = .03 + W(R_1 - .03) + (W/2)(R_2 - .09)$

Guarantee Duration	Calendar Year	W	Valuation (100%) 1980	1981	1982	Nonforfeiture (125%) 1980	1981	1982
	R_1		8.92	9.00	9.00			
	R_2		9.00	9.89	11.57			
10 years or less		.50	6.00	6.00	6.75	7.50	7.50	8.50
more than 10, not more than 20		.45	5.75	5.75	6.25	7.25	7.25	7.75
more than 20		.35	5.00	5.00	5.50	6.25	6.25	7.00

(b) Single Premium Immediate Annuities $I = .03 + W(R - .03)$

	W	1980	1981	1982
R		11.51	13.71	NA
	.80	9.75	11.50	NA

(c) Other Annuities

	Formula	Type Plan	Guarantee on considerations received more than one year after issue W	1980	1981	1982	No such guarantee W	1980	1981	1982
(i) Issue year basis valuation		R	(b)	11.51	13.71	NA		11.51	13.71	NA
		R_1	(a)	9.00	9.00			9.00	9.00	
With cash settlement option		R_2	(a)	9.89	11.57			9.89	11.57	
5 years or less	Formula (b)	A	.80	9.75	11.50		.85	10.25	12.00	
		B	.60	8.00	9.50		.65	8.50	10.00	
		C	.50	7.25	8.25		.55	7.75	9.00	
more than 5 but not more than 10 years	Formula (b)	A	.75	9.50	11.00		.80	9.75	11.50	
		B	.60	8.00	9.50		.65	8.50	10.00	
		C	.50	7.25	8.25		.55	7.75	9.00	
more than 10 but not more than 20 years	Formula (a)	A	.65	7.25	7.75		.70	7.50	8.00	
		B	.50	6.25	6.75		.55	6.50	7.00	
		C	.45	6.00	6.25		.50	6.25	6.75	

more than 20 years	Formula (a)	A	.45	6.00	6.25		.50	6.25	6.75	
		B	.35	5.25	5.50		.40	5.50	6.00	
		C	.35	5.25	5.50		.40	5.50	6.00	

With no cash settlement option - same as with cash settlement except for:

more than 10 but not more than 20 years	Formula (b)	A	.65	8.50	10.00	NA	Not a Possible Plan			NA
		B	Not a Possible Plan				Not a Possible Plan			
		C	Not a Possible Plan				Not a Possible Plan			
more than 20 years	Formula (b)	A	.45	6.75	7.75		Not a Possible Plan			
		B	Not a Possible Plan				Not a Possible Plan			
		C	Not a Possible Plan				Not a Possible Plan			
(ii) Change in fund basis valuation			*				No Such Guarantee			
5 years or less	Formula (b)	A	.95	11.00	13.25		1.00	11.50	13.75	
		B	.85	10.25	12.00		.90	10.75	12.75	
		C	.55	7.75	9.00		.60	8.00	9.50	
more than 5 but not more than 10 years	Formula (b)	A	.90	10.75	12.75		.95	11.00	13.25	
		B	.85	10.25	12.00		.90	10.75	12.75	
		C	.55	7.75	9.00		.60	8.00	9.50	
more than 10 but not more than 20 years	Formula (b)	A	.80	9.75	11.50		.85	10.25	12.00	
		B	.75	9.50	11.00		.80	9.75	11.50	
		C	.50	7.25	8.25		.55	7.75	9.00	
more than 20 years	Formula (b)	A	.60	8.00	9.50		.65	8.50	10.00	
		B	.60	8.00	9.50		.65	8.50	10.00	
		C	.40	6.50	7.25		.45	6.75	7.75	

* Guarantee on considerations received more than 12 months beyond the valuation date

August 21, 1981

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ATTACHMENT ONE-E

State of California
Department of Insurance
600 South Commonwealth Avenue
Los Angeles, California 90005
(213) 736-2533

August 7, 1981

Lyndon Olson, Jr.
Chairman of Life (A) Committee
State of Texas
Department of Insurance
1110 San Jacinto Street
Austin, Texas 78786

Subject: NAIC Life (A) Committee Actuarial Task Force

Dear Mr. Olson:

Ted Becker has asked me to furnish you with an outline of projects of the former (C4) Technical Subcommittee which should be carried on by a successor task force of the Life (A) Committee. These are:

1. The construction of mortality and/or morbidity experience tables for the purpose of determining minimum required reserves and nonforfeiture or refund values where applicable.

   a. Projects now in progress are:

      (1) Mortality of annuitants

      A special committee of the Society of Actuaries is working on this.

      (2) Disability experience for disability waiver of premium and disability monthly income benefits attached to life insurance policies.

      The special Society of Actuaries Committee assigned the task of constructing new disability tables has also been asked to do this project.

      (3) Pilot studies of credit life insurance mortality experience and credit disability insurance morbidity experience.

      These studies are being made by a special committee appointed by the Society of Actuaries and this initial phase concerns the experience on business issued by finance companies and brokers specializing in small loans.

   b. Projects which are yet to be initiated but are urgently needed are:

      (1) Super select mortality tables including non-smoker risks. This also includes the construction of mortality tables for the remainder of the population, not classified as standard but which would be reclassified as nonsuper select.

      (2) Mortality on substandard lives.

      (3) Mortality on guaranteed issue plans and other plans with limited or no underwriting selection of risks.

2. The matching of assets and liabilities and the determining of the minimum amount of surplus based upon the risks assumed and the level of reserve liabilities maintained. Under this topic are several subtopics such as:

   a. The adequacy of investment income to meet that required to maintain the policy and other fund reserves and the establishment of a special reserve requirement where investment income is insufficient.

   b. The adequacy of the premium and investment income to meet the guaranteed cash surrender benefit requirements in certain forms of high cash value policies.

3. Continual review of the model valuation and nonforfeiture laws to see if further revision is needed.

4. The preparation of actuarial guidelines on a variety of subjects.

   a. Those guidelines related to valuation of policy reserves which the task force is currently considering are:

      (1) The valuation of group annuities

      (2) Reserves for annuities with contingent liabilities

      (3) Reserves for annuities arising from property and casualty settlements

      (4) Definitions involving annuities for the purpose of determining which valuation method, life insurance or annuity, is appropriate

      (5) Reserves and nonforfeiture values for universal life and interest indexed plans.

b. Those guidelines which have been adopted but yet must be implemented by publication in the NAIC Examiners Handbook are:

(1) Revision wording of Actuarial Guideline II "Valuation of Active Life Funds Held Relative To Group Annuity Contracts".

(2) "Interpretation of the NAIC Model Nonforfeiture Law For Individual Deferred Annuities".

c. Those guidelines related to product design which the task force is currently considering are:

(1) Updating guidelines and possibly model regulations for variable life insurance policies and variable annuity contracts.

(2) Updating of existing life insurance policies to allow for improved mortality and higher interest rate assumptions.

(3) The definition of problems related to the interest rate differentials between those valuation assumptions and those assumed for nonforfeiture benefit calculations and the recommended solution to such problems.

5. The organization editing and publishing of the proceedings of the former (C4) Technical Subcommittee over the first few years. This could become a valuable text book and a source of income to the NAIC.

Since the old (C4) Technical Subcommittee had been working with primarily actuarial problems I suggest that the Life (A) Committee appoint an "Actuarial Task Force" to carry on the work of the Technical Subcommittee. The commissioners listed below should be contacted to see if they, or their technical staff, can serve. Meetings would consist primarily of technical staff but any commissioner is welcome to participate. I have not yet been able to contact them or their staff.

Members of the task force should include as many of the following as wish to participate:

	W. H. L. Woodyard, III	Arkansas	(Joe Musgrove)
(A)	Robert Quinn	California	(John Montgomery)
(A)	Johnnie L. Caldwell	Georgia	(Ed Flickner)
	Philip R. O'Connor	Illinois	(Larry Gorski)
	Donald H. Miller	Indiana	(W. H. Wetterstrand)
*	Daniel D. Briscoe	Kentucky	(W. Keith Sloan)
	Patsy Redmond	Nevada	(Irma Edwards)
	James J. Sheeran	New Jersey	(William A. White)
	Albert B. Lewis	New York	(Thomas J. Kelly)
	John W. Lindsay	South Carolina	(Douglas Broome)
(A)	Lyndon Olson, Jr.	Texas	(Ted Becker)
(A)	Roger C. Day	Utah	(Bert Gottfredson)
(A)	Susan Mitchell	Wisconsin	(Bradford S. Gile)

* Not a member of the former (C4) Technical Subcommittee but Keith Sloan had served when he was with the Arkansas Department

(A) Members of the Life (A) Committee

For the present with your permission the technical staff will continue to operate on an "ad hoc" basis. However any notices of meetings should probably be sent over your signature unless you authorize Ted Becker or me to call such meetings.

Very truly yours,

John O. Montgomery, F.S.A., M.A.A.A.
Chief Actuary and
Deputy Insurance Commissioner

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ATTACHMENT ONE-F

State Board of Insurance
1110 San Jacinto
Austin, Texas 78786
512/475-3325

November 23, 1981

Mr. Lyndon Olson, Jr., Board Member
State Board of Insurance
1110 San Jacinto
Austin, Texas 78757

Re: Actuarial Guidelines Intended for
NAIC Financial Condition Handbook –
Recommendation for December 1981 NAIC Meeting

Dear Mr. Olson:

This letter is written to you in your capacity as chairman of the NAIC (A) Life Insurance Committee. I am writing on behalf of the informal group of state insurance department actuaries known as the Life, A&H Technical Staff Actuarial Group.

The Life, A&H Technical Staff Actuarial Group would like to call your attention to two matters involving actuarial guidelines at this time. Prior to the recent reorganization of the NAIC, actuarial guidelines were added to the NAIC Financial Condition Handbook by a two step process. Changes in existing actuarial guidelines were accomplished when needed by a similar process.

First, the former (C4) Life, Accident and Health Insurance Technical Subcommittee would recommend the new actuarial guidelines (or the change in an existing guideline) to the former (C3) Life Insurance Subcommittee. If the recommendation was adopted by the (C3) Subcommittee at a certain NAIC meeting, the (C4) Technical Subcommittee would then make the same recommendation to the former (A5) Financial Condition Examination Committee for adoption at the next NAIC meeting approximately six months later. The new actuarial guideline (or the change in an existing actuarial guideline) was accomplished and introduced into the handbook only after both the (C3) and the (A5) Subcommittees had adopted the recommendation.

Please see the two enclosures to this letter, consisting of my letters to Commissioner J. Richard Barnes of Colorado dated May 8, 1981, along with their attachments. Both of these letters relate to matters which were adopted by the (C3) Subcommittee in June 1981. Now that the (A5) Subcommittee has ceased to exist, it is not clear what else is needed. At the suggestion of Jon Hanson of the NAIC Support and Services Office, I am writing to you and sending a copy of this letter to Commissioner Michael D. Markman of Minnesota, Chairman of the NAIC (EX4) Financial Condition Subcommittee. I am also sending a copy to Commissioner Voorhis but not to any of the other State Insurance Commissioners at this time.

The Life, A&H Technical Staff Actuarial Group recommends adoption of the new actuarial guideline entitled "GUIDELINE FOR INTERPRETATION OF NAIC STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES." (The enclosed letter to Commissioner Barnes and the copy of its attachment use the title "PROPOSED GUIDELINE FOR INTERPRETATION OF NAIC STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES," but the word "proposed" is deleted in accordance with the decision of the former (C3) Subcommittee at its June 1981 meeting. The (C3) Subcommittee adopted this actuarial guideline at its June 1981 meeting with no other changes.)

The Life, A&H Technical Staff Actuarial Group also recommends a change in the existing Actuarial Guideline II, which appears on pages 297 and 298 of the Handbook and which is entitled "VALUATION OF ACTIVE LIFE FUNDS HELD RELATIVE TO GROUP ANNUITY CONTRACTS." The change which was recommended to the former (C3) Subcommittee was adopted verbatim by that subcommittee in June 1981. However, the Life, A&H Technical Staff Actuarial Group met on October 17, 1981. On the basis of more complete and more current information our group now recommends that the table on page 298 should show a value of "i_{my}" of .100 rather than the .095 for the calendar year 1980 and that this table should also be extended to show a value of .124 for calendar year 1981.

Please let me know if anything else is needed to have these two matters considered for adoption in 1981. I will be pleased to answer any questions you may have.

Very truly yours,

Ted Becker,
for the
Life, A&H Technical Staff
Actuarial Group.

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ATTACHMENT ONE-F1

State Board of Insurance
1110 San Jacinto
Austin, Texas 78786
512/475-3325

May 8, 1981

Commissioner J. Richard Barnes
Colorado Department of Insurance
106 State Office Building
Denver, Colorado 80203

Re: Request for Adotpion of a
New Actuarial Guideline Entitled
"PROPOSED GUIDELINE FOR INTERPRETATION OF
NAIC STANDARD NONFORFEITURE LAW FOR
INDIVIDUAL DEFERRED ANNUITIES"
by the NAIC (C3) Subcommittee in June 1981

Dear Commissioner Barnes:

The NAIC (C4) Technical Subcommittee recommends that the NAIC (C3) Subcommittee adopt a new actuarial guideline at its June 1981 meeting. This guideline is now entitled "Proposed Guideline for Interpretation of NAIC Standard Nonforfeiture Law for Individual Deferred Annuities," but the word "proposed" is to be deleted if the guideline is so adopted.

The attachment to this letter gives the entire text of the proposed guideline.

As in the case of other actuarial guidelines, this proposed guideline is intended for eventual inclusion in the NAIC Financial Condition Examiners Handbook. Such inclusion would require that both the (C3) Subcommittee and the (A5) Subcommittee adopt the guideline. If it is adopted by the (C3) Subcommittee in June 1981, the (C4) Technical Subcommittee intends to submit it on to the (A5) Subcommittee with a recommendation for adoption in December 1981 to complete this procedure.

As the title of this proposed guideline indicates, it interprets the Standard Nonforfeiture Law for Individual Deferred Annuities. Specifically, the guideline is concerned with the determination of minimum cash surrender benefits for such annuities in cases where excess interest or dividends have been credited to the contract.

The (C4) Technical Subcommittee had been studying such cases for some time and had asked the American Council of Life Insurance (ACLI) to present its views. This proposed guideline was then developed by the ACLI and recommended to the (C4) Technical Subcommittee in August 1980. Subsequently, the guideline was reviewed by the new American Academy of Actuaries Subcommittee for Liaison (Life Insurance) with the NAIC (C4) Technical Subcommittee. This Academy Subcommittee also recommended the guideline to the (C4) Technical Subcommittee in April 1981. The (C4) Technical Subcommittee then voted to adopt the guideline in April 1981, at its meeting in San Francisco.

The text of the proposed guideline in the attachment to this letter is identical to that which was originally recommended by the ACLI. This text was included in Attachment 15 in the December 1980 Semi-Annual Report of the (C4) Technical Subcommittee.

Please let me know if you have any questions.

Very truly yours,

Ted Becker, Chairman, NAIC (C4) Life, Accident and Health Insurance Technical Subcommittee.

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PROPOSED GUIDELINE FOR INTERPRETATION OF NAIC STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES

For contracts which provide cash surrender benefits, the NAIC model law prescribes a basis for determination of minimum cash surrender benefits. That law does not require that a company grant additional amounts in excess of the amounts guaranteed in the contract, either in the form of excess interest credits or otherwise. When such additional amounts have been credited to the contract, the question of how the model law applies to such amounts must be considered.

Under one interpretation the portion of the maturity values which would arise from such amounts may be discounted to the date of surrender at an interest rate 1% higher than the rate specified in the contract for accumulating such amounts. This interpretation would permit a surrender charge against such amounts on the same basis as the surrender charge which may be applied to the contractually guaranteed portion of the interest credited to the contract.

Under another interpretation such amounts could not be treated as providing a portion of the maturity value and, therefore, would be included in the phrase "any additional amounts credited by the company to the contract". This interpretation would require that the cash surrender value be increased by 100% of the accrued value of such amounts.

By providing for a surrender charge to be made in determining the minimum cash surrender value, the model law enables a company to provide for recovery of all or part of any (1) excess first year expenses not yet recovered, and (2) potential investment losses at surrender. The reason for permitting surrender charges to be made against accumulated amounts of contractually guaranteed interest are equally valid reasons for permitting surrender charges against any nonguaranteed interest credited. If such surrender charges were not permitted, companies offering such contracts may be discouraged from crediting as much additional interest as they might if the additional interest were to contribute to the minimum cash surrender value in the same manner as do the interest amounts derived from the rates guaranteed in the contract.

In view of the above considerations, the following guidelines are recommended:

I. TREATMENT OF AMOUNTS OF EXCESS INTEREST CREDITED TO DEFERRED ANNUITY CONTRACTS

The NAIC Standard Nonforfeiture Law for Individual Deferred Annuities shall be interpreted to permit the portion of the maturity value which would arise from the amounts of interest credited in excess of the minimum rates guaranteed in the contract to be discounted to the date of surrender at an interest rate 1% higher than the rate specified in the contract for accumulating such amounts, provided such excess interest is declared prior to the period for which it is to be effective, and provided such excess interest accures over the effective period. Amounts of excess interest treated in accordance with the above interpretation shall not be included by the phrase "additional amounts credited by the company to the contract" in Section 6 of the model law.

II. TREATMENT OF DIVIDENDS CREDITED TO DEFERRED ANNUITY CONTRACTS

No single rule can be given for the treatment of dividends credited to deferred annuity contracts. The contractual wording of the applicable dividend option must be taken into account together with the appropriate provisions of the NAIC Standard Nonforfeiture Law for Individual Deferred Annuities.

If the dividend option in effect provides that dividends be left on deposit at interest, without any further qualification, then the cash surrender value should be increased by the full accumulated amount. In this case, the phrase "increased by any additional amounts credited by the company to the contract" applies and no surrender charge may be made.

In other cases, the dividends may be added, directly or indirectly, to the contractual value and made subject to the surrender charge provision. This would be the case when dividends are applied to purchase additional paid-up benefits or applied as premiums.

Contracts may contain other provisions or variations of these provisions. In such cases, the terms of the contract and the provision of the NAIC Standard Nonforfeiture Law for Individual Deferred Annuities should be taken into account.

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ATTACHMENT ONE-F2

State Board of Insurance
1110 San Jacinto
Austin, Texas 78786
512/475-3325

May 8, 1981

Commissioner J. Richard Barnes
Colorado Department of Insurance
106 State Office Building
Denver, Colorado 80203

Re: Request for Adoption of a Change in
Existing Actuarial Guideline II
Entitled "VALUATION OF ACTIVE LIFE FUNDS
HELD RELATIVE TO GROUP ANNUITY CONTRACTS"
by the NAIC (C3) Subcommittee in June 1981

Dear Commissioner Barnes:

The NAIC (C4) Technical Subcommittee recommends that the NAIC (C3) Subcommittee adopt a change in an existing actuarial guideline at its June 1981 meeting. The change would affect Actuarial Guideline II, entitled "Valuation of Active Life Funds Held Relative to Group Annuity Contracts," appearing on pages 297 and 298 of the NAIC Financial Condition Examiners Handbook.

The recommended change would add a new paragraph between the second and third paragraphs of this guideline, reading as follows:

> "The valuation procedures and standards specified in this guideline shall not be applicable to the extent that the valuation procedures and standards relating to reserves for deposit administration group annuity funds with interest rate guarantees (i.e., group annuity and guaranteed interest contracts) in the amendments to the Standard Valuation Law adopted by the National Association of Insurance Commissioners in December 1980, or in later NAIC amendments, have become applicable in a jurisdiction."

The attachment to this letter is a marked-up copy of Actuarial Guideline II, illustrating this proposed change.

The proposed change makes it clear that Actuarial Guideline II would no longer apply after the Standard Valuation Law provides a specific manner for treating these types of contracts. Actuarial Guideline II had been intended only as an interim measure.

If this change is adopted by the (C3) Subcommittee in June 1981, the (C4) Technical Subcommittee intends to recommend it on to the NAIC (A5) Subcommittee for adoption in December 1981. Adoption by both these NAIC subcommittees is required in order to complete the procedures for material to be included in the NAIC Financial Condition Examiners Handbook.

Please let me know if there are any questions.

Very truly yours,

Ted Becker, Chairman, NAIC (C4) Life, Accident and Health Insurance Technical Subcommitte.

****

The valuation procedures and standards specified in this guideline shall not be applicable to the extent that the valuation procedures and standards relating to reserves for deposit administration group annuity funds with interest rate guarantees (i.e., group annuity and guaranteed interest contracts) in the amendments to the Standard Valuation Law adopted by the National Association of Insurance Commissioners in December 1980, or in later NAIC amendments, have become applicable in a jurisdiction.

Add New Paragraph

ACTUARIAL GUIDELINE II

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 as 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 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 described 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
1978	.081
1979	.084
1980	.100
1981	.124

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

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ATTACHMENT ONE-G

State Board of Insurance
1110 San Jacinto
Austin, Texas 78786
512/475-3325

December 4, 1981

Mr. Lyndon Olson, Jr., Board Member
State Board of Insurance
1110 San Jacinto
Austin, Texas 78786

Re: Document Entitled: "Review of Sex Distinct Pricing in Individually Marketed Insurance"
–Recommendation for Adoption by NAIC (A) Committee in December 1981

Dear Mr. Olson:

This letter is written to you in your capacity as chairman of the NAIC (A) Life Insurance Committee.

Please refer to the enclosed copy of my letter of November 18, 1981, to Director J. Michael Low and the attached document entitled "Review of Sex Distinct Pricing in Individually Marketed Insurance."

This same document is also pertinent to the work of the (A) Life Insurance Committee, and it should be considered by both the (A) Committee and the (B) Committee. Through oversight, it was submitted for adoption in December 1981, only to the (B) Committee on November 18, 1981. The purpose of my letter to you is to correct that oversight, so that it is submitted to the (A) Committee also.

The document has already been mailed to all State Insurance Commissioners on November 18, 1981, so that it will have had around 30 days of exposure to the commissioners when the (A) Committee meets on December 17, 1981. The document itself has been published in the "Compilation of Reports" for the June 1981 NAIC meeting. Presumably, interested persons have now had a reasonable opportunity to examine the document. Therefore, the Life, A&H Technical Staff Actuarial Group recommends that the (A) Committee adopt this document at its meeting on December 17, 1981.

I would be pleased to answer any qestions.

Very truly yours,

Ted Becker, for the
Life, A&H Technical Staff Actuarial Group

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ATTACHMENT ONE-G1

State Board of Insurance
1110 San Jacinto
Austin, Texas 78786
512/475-3325

November 18, 1981

Director J. Michael Low
Arizona Department of Insurance
1601 West Jefferson
Phoenix, Arizona 85007

Re: Document Entitled
"Review of Sex Distinct Pricing in
Individually Marketed Insurance"
Recommendation for Adoption by
NAIC (B) Committee in December 1981

Dear Director Low:

The informal group of state insurance department actuaries known as the Life, A&H Technical Staff Actuarial Group agreed at its meeting on October 18, 1981, to recommend the above document for adoption by the NAIC (B) Accident and Health Committee. Accordingly, I am writing you in your capacity as Chairman of the (B) Committee, and I am requesting that your committee consider and adopt this document at its next meeting in December 1981.

A copy of this document is enclosed for reference.

This document was developed by the former (C4) Life, Accident and Health Insurance Technical Subcommittee at the June 1981 NAIC Meeting. The complete text of the document appears on Pages 870-873 in the "Compilation of Reports" for that meeting. As stated on page 553 in the "Compilation of Reports," the (C1) Committee voted at its June 1981 Meeting to receive the document, but to defer any further action for possible comments from members.

I am not aware of the existence of any letters with any unfavorable comments about this document.

In accordance with our recent telephone conversation, I am sending a copy of this letter and a copy of the document to all other State Insurance Commissioners.

Please let me know if you have any questions.

Very truly yours,

Ted Becker, for the
Life, A&H Technical Staff Actuarial Group

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REVIEW OF SEX DISTINCT PRICING IN INDIVIDUALLY MARKETED INSURANCE

In December, 1979 the NAIC Accident and Health (C1) Subcommittee Task Force on Sex Discrimination asked this (C4) Technical Subcommittee to review a statement given to the task force on April 9, 1979, by the Health Insurance Association of America and the American Council of Life Insurance and to review any other relevant actuarial data. The (C4) Subcommittee was asked to report to the (C1) Subcommittee on whether there would be a significant disadvantage to the public from (1) requiring that individual health insurance premium rates be the same, regardless of sex; and (2) requiring that the cost of normal pregnancy coverage be charged to a broader group of persons than those who want or need the coverage. The (C4) Subcommittee, by letter from Larry Gorski of Illinois dated May 12, 1981, requested the American Academy of Actuaries to prepare a discussion of the same questions. In August, 1980, a report was received from the Health Subcommittee of the American Academy of Actuaries Committee on Risk Classification.

The (C4) Technical Subcommittee assigned to Larry Gorski, Thomas Kelly of New York, and Spencer Hamilton of Utah, the task of reviewing the details of these reports and reporting back to the subcommittee. They have done this in the form of Larry Gorski's letter of March 17, 1981 to Ted Becker of Texas. The (C4) Life, Accident and Health Insurance Technical Subcommittee has reached the following conclusions based on current data:

1. Claim costs under individually marketed and group health insurance vary significantly by sex. It is, therefore, actuarially appropriate and advantageous to the public for individually marketed health insurance premium rates to vary by sex and for group health insurance premium rates to take into account the respective distributions by sex in the various groups insured.

2. Spreading the cost of normal pregnancy outside the group of persons at risk would produce unfair results which are unnecessary and undesirable.

These conclusions are based on currently available evidence. The fact that the amounts of cost differentials based on sex continue to change means that investigation must continue and trends must be followed up so that we can properly respond to emerging experience.

In the course of considering these questions, we have become aware of the fact that several bills have been introduced in the U.S. Congress which would prohibit sex-based pricing differentials in all lines of insurance, even where there are statistically demonstrated cost differences. If there is to be a viable insurance system in this country, it must have a risk classification system that protects the insurance system's financial soundness; that is fair to insurance buyers; and that permits economic incentive to serve the broadest possible market.

It is generally the position of the actuarial profession that insured individuals are treated equally if they are charged prices which equitable reflect the value of the risks they transfer to the insurance pool – not simply as a matter of theoretical preference but as a necessary condition to the sound operation of insurance programs. Determining the value of the risks transferred necessarily involves the use of averages and classification variables; therefore, the use of averages and class groupings is fundamental to insurance. Consideration of what is fair or unfair in insurance must take place within that conceptual framework.

In testimony on H.R. 100, A Bill to Prohibit Sex Discrimination in Insurance, given before the House Subcommittee on Consumer Protection and Finance on August 28, 1980, the American Academy of Actuaries Committee on Risk Classification identified the key question regarding this proposed legislation as one of whether the social benefits, if any, to be derived from the legislation, outweigh the disadvantages inherent in the elimination of cost-based pricing and the disruptions of the marketplace which it implies. Based on more recent testimony submitted to the House Subcommittee on Commerce, Transportation, and Tourism on May 20, 1981, by the American Academy of Actuaries Committee, we believe the answer to this question is no. Cost based pricing is critical to all commercial activities and to prohibit premium rates in insurance from reflecting the estimated cost of the risk would lead to great instability in the insurance marketplace and would actually interfere with free access to insurance by many customers.

Some of the more important possible effects identified in the American Academy of Actuaries Committee's testimony are the following:

A. An increase in the average price of insurance in general, as insurers are forced to take on the additional risk that the sex distribution of those insured will be different from what has been assumed in pricing.

B. Increased emphasis on selling insurance for the arbitrarily overpriced risks, along with possible steps to avoid selling insurance for risks that are known to be relatively underpriced.

C. Increased regulatory efforts and costs to assure equal availability of coverage, especially to those for whom insurance prices are arbitrarily reduced.

D. Adoption of new classification factors or product modifications, some of which may have the effect of differentiating risks by sex.

E. Diversion of resources to the implementation of unisex rating, at the expense of new insurance product development efforts or investigation of other new pricing techniques.

As indicated in the testimony of the American Academy of Actuaries Committee, a significant economic impact and disruption of insurance markets would result from failing to reflect cost differences by sex in insurance pricing. Therefore, we recommend that the NAIC endorse the use of a risk classification system which appropriately reflects cost differences by sex for individually marketed insurance, and both cost differences and distribution by sex within a group for group insurance, as being in the best interests of buyers of insurance.

LIFE COST DISCLOSURE (A) TASK FORCE

Reference: Formerly part of Life Insurance (C3) Subcommittee
1981 Proc. I p. 515
1981 Proc. II p. 643

Lyndon L. Olson, Jr., Chairman – Texas
James J. Sheeran, Vice-Chairman – New Jersey

AGENDA

1. Report of October, 1981 Vermont meeting.

2. Any other matters brought before the task force.

CONTENTS

December, 1981 report . . . 394
Statement of Joe Mintz on life insurance cost disclosure (Attachment One) . . . 396
Statement of the National Insurance Consumer Organization on life insurance cost disclosure (Attachment Two) . . . 397
Memorandum on the Report of the Task Force on Life Insurance Replacement (Attachment Three) . . . 398
Statement of the American Council of Life Insurance on life insurance cost disclosure (Attachment Four) . . . 399
Task force report of the Subcommittee on Cost Comparisons (Attachment Four-A) . . . 399
Proposed Revision of NAIC Life Insurance Solicitation Model Regulation and Life Insurance Buyer's Guide (Attachment Five) . . . 402

The Life Cost Disclosure (A) Task Force met in the Grand Ballroom C of the New Orleans Hilton in New Orleans, Louisiana at 9:00 a.m. on December 15, 1981. A quorum was present and Lyndon Olson, Jr., chaired the meeting. The following task force members or their representatives were present: Lyndon Olson, Jr., Chairman (Texas); James J. Sheeran, Vice Chairman (New Jersey); W.H.L. Woodyard, III (Arkansas); Michael J. Sabbagh (Massachusetts); Patsy Redmond (Nevada); Rogers T. Smith (South Carolina); and Susan Mitchell (Wisconsin).

Chairman Olson of Texas reported briefly that no quorum was obtained for the October, 1981 Vermont meeting and that the meeting today was called based on inquiries from commissioners and industry.

Erma Edwards (Nevada) presented an extensive paper summarizing several amendments to the Life Insurance Solicitation Regulation and Buyer's Guide. These amendments were submitted to the (C3) Subcommittee last June as exposure drafts (NAIC Proceedings, Vol. II, 1981, Pages 643-760). The task force received her report as a working paper.

Joe Mintz, Dallas, presented a statement to the task force (a copy will appear as part of the official Proceeding of the NAIC. *See Attachment One.*) that concluded, ". . . the interest adjusted method should no longer be used as a guide to the comparative cost between any two life insurance policies." Mr. Mintz invited the task force to either provide an accurate cost comparison system by June, 1982 or deregulate cost disclosure.

A statement from James Hunt, FSA, director of the National Insurance Consumer Organization (NICO) was entered into the record (a copy will appear as part of the official Proceeding of the NAIC. *See Attachment Two*). Mr. Hunt's statement called for action in addressing disclosure as it relates to the new universal life product and further called for revision of the interest rate used to index life insurance policies.

Robert J. Lodewick, Jr., counsel for Massachusetts Indemnity and Life Insurance Company, presented a report urging consideration of the Report by the Task Force on Life Insurance Replacement by the Illinois Insurance Department. Mr. Lodewick highlighted the report (a copy will appear as part of the official Proceeding of the NAIC *See Attachment Three*) by noting that the Illinois report surveyed companies and concluded only threetenths of one percent of policies-in-force are "replacement" business. Based on that survey, simplified replacement regulation without comparison forms were recommended in Illinois, and he urged consideration of the approach in other states.

John Booth, American Council of Life Insurance (ACLI), presented a paper on cost disclosure for universal life products (a copy will appear as a part of the official Proceeding of the NAIC *See Attachment Four*). He recommended disclosure of the difference between cost indexes based on the guaranteed and the currently illustrated premiums, death benefits, cash surrender values and endowment amounts. Further, the policy summary should include a statement on the point at which the policy will expire based on the policy guarantees and the anticipated premiums shown in summary. Basically, he summarized universal life should be treated as a life insurance plan with a nonguaranteed cost element for cost disclosure purposes.

Ted Becker (Texas), observed in response to Mr. Booth's report, that the Life A&H Technical Staff Actuarial Group is studying the universal life product including needed disclosure.

Commissioner Bruce W. Foudree (Iowa), chairman of the Securities and Insurance Regulation Task Force, observed that there may be some overlap in the jurisdictions of his task force and the Life Cost Disclosure Task Force. He indicated that as regulatory responses to the new forms of life insurance were developed, the two task forces should work together.

Henry Katz, Hartford Insurance Group, noted in response to the calls for disclosure on universal life insurance products that the Hartford is offering the new product in a way to provide full disclosure. He offered his company's assistance in developing any new regulation of this product.

Having no further business, the task force adjourned subject to the call of the chair at 10:00 a.m.

Lyndon L. Olson, Jr., Chairman, Texas; James J Sheeran, Vice-Chairman, New Jersey; W. H. L. Woodyard, III, Arkansas; Joseph C. Mike, Connecticut; Don H. Miller, Indiana; Michael J. Sabbagh, Massachusetts; Patsy Redmond, Nevada; John R. Ingram, North Carolina; Rogers T. Smith, South Carolina; Roger C. Day, Utah; Susan Mitchell, Wisconsin.

ATTACHMENT ONE

STATEMENT TO COST DISCLOSURE COMMITTEE
OF JOE A. MINTZ

December 15, 1981

Suppose your pet animal died after treatment from the vet. He apologized by explaining the method used for the "cure" is mandated by the State Board of Examiners. Further checking establishes that the examiners are aware of the problem caused by a hasty board decision some years back.

Over the years, hearing after hearing, claims are made by industry as well as regulators that no complaint comes from widows and orphans when a death check is paid by a life insurance company.

But if the widows or orphans were aware that a vast difference in the cost of life insurance exists . . . not only term against term or whole life against whole life and whole life against term . . . but other combinations of life insurance could provide as much as two or three times the amount of the death check might have been paid . . . there would not be the satisfied acceptance of the death check.

It is not just the widows and orpans who are duped. Agents sign up with the wrong company because of deceptive cost comparisons, fail in the business because they shift from company to company.

Sophisticated buyers of life insurance who read ads in the major public press are mislead by advertisements which surely some member of the family of regulators reads.

At your meeting in December 1980 in New York, the Task Force presented a report stating that the interest adjusted method is "defective and fatally flawed." That is the opinion of other creditable persons not a part of the committee but are educators or actuaries at companies or departments of insurance.

I do not intend to go on and on establishing a fact which you yourselves have already proven.

I suggest that you dig out a speech on The Tort Liability of the Life Underwriter given by Mr. Oliver Townsend, past general counsel of the Continental Insurance Company.

Further you should seek legal guidance on your own liability for mandating a system of mathematics which at the very best is questionable.

In this era of the computer and the claims it causes life insurance agents to make at your demand, and the fact that these documents are left behind, there is no question that the time is ripe for not only the well informed widow who remembers the sales presentation and agreed with her husband to purchase one policy as opposed to another by a defective system used by a professional life underwriter and mandated by the state . . . but take the case of the individual who purchases less life insurance than the professional life underwriter proposes as the proper amount with the expectation of purchasing more in the years to come. Later finds himself uninsurable. Later learns that the mathematics to cause the purchase one plan against another is defective and fatally flawed . . . who is responsible? Is it the professional life underwriter who should have known better, is the publisher of books providing defective information liable, is the advertising departments of insurance companies who know no mathematics, or is it the regulators who have mandated the system?

I suggest that at this meeting you declare officially that the interest adjusted method should no longer be used as a guide to the comparative cost between any two life insurance policies. Then by your meeting in June decide upon an accurate system or bow out of the question entirely. By not acting immediately you are providing no help to the industry, the agents who serve the public, and most of all you as regulators are not acting in the best interest of those who you serve.

****

ATTACHMENT TWO

STATEMENT OF JAMES HUNT, FSA, DIRECTOR NATIONAL INSURANCE CONSUMER ORGANIZATION BEFORE THE NAIC TASK FORCE ON LIFE INSURANCE COST DISCLOSURE

December 15, 1981

More than a year ago, a National Association of Insurance Commissioners (NAIC) task force brought forth a new life insurance cost disclosure system that promised to aid consumers in their life insurance purchases. The proposal was one of the most creative ever seen in the annals of the NAIC, but the lfie insurance industry brought out its big guns and shot it down. Since that time, we have seen very little movement on the issue, except for a task force meeting in Chicago that, as far as we know, produced no work product.

Consumers, meanwhile, have been blitzed by full page newspaper advertisements for the "revolutionary" new product, "universal life." They are being told to cash in their old policies in favor of universal life (or term/annuity packages, or other new variations on the old whole life scheme), despite the fact that most would be better off keeping their old policies. They have no way of knowing whether the old is better than the new because the NAIC Model Replacement Regulation, which has been promulgated in many states, is completely worthless, permitting, as it does, apples-and-oranges comparisons between new and old policies. Nor does it require any index number corresponding, say to the Surrender Cost Index for the 20th year required in many states for new policies, so that new and old might be compared.

Under the NAIC Model Solicitation Regulation for Life Insurance, a warning is given that the prospective buyer should not use the interest-adjusted numbers to compare dissimilar policy forms. This is, of course, one of its fatal weaknesses, since more than an occasional buyer is aware of the differences between term and whole life and should have some means of comparing these dissimilar forms. With the advent of universal life, a form of whole life, it is now possible to say that only coincidently may the NAIC Interest-adjusted method be used to compare whole life and universal life. (The reason is due to differing amounts at risk flowing out of widely differing premium levels.) We asked the chief executive officer of one universal life insurance company what relevance the NAIC disclosure system had for sales of his new product; his reply was "zero." Indeed, the Surrender Cost Index for universal life can be negative, and we defy anyone to articulate an understandable explanation of what negative index numbers mean.

To emphasize the point in the previous paragraph, the NAIC method is so completely discredited that it may no longer be used even to compare certain similar policy forms.

All parties to the life insurance cost disclosure debate can agree that the subject is technically difficult. Indeed, one of the major reasons why no improvements have been made is that all the "experts" have their own bright ideas on the best alternative disclosure method. (NICO does not excuse itself from this comment.) But we do not think the discredited NAIC method should continue to be used simply because agreement on a new course is difficult.

At the Chicago meeting of the Task Force on Life Insurance Cost Disclosure, ex-Commissioner Jay Newman of Virginia presented a preview of a study of life insurance marketing practices his department was then undertaking. That study of life insurance marketing practices his department was then undertaking. That study is now available, and we recommend that the NAIC task force look at its recommendations as possible middle ground it could seek in this long debate over methodology. The report does not recommend abandonment of the interest-adjusted method, for example; instead, it suggests use of the interest-and-mortality adjusted method, a variation on the same theme that has the great advantage of eliminating the rule that dissimilar forms may not be compared and reducing the number of index numbers given.

Apart from structural reform of the NAIC method, continued use of a five percent interest rate for the current index numbers is wholly unjustified. This is not only due to much higher interest rates we have seen in recent years, but is necessary because interest rates being used in dividend formulas are so much higher than five percent that negative surrender cost indicies are beginning to appear. This situation will get worse as 1982 dividend scales are illustrated. It is worthwhile remembering that the life insurance cost disclosure movement got started because of regulatory and consumer concern over the old net cost method that was producing negative "net costs;" the old net cost method is simply the interest-adjusted method is at zero percent interest.

NICO calls on the NAIC to get moving. If you can't overcome industry opposition to a meaningful cost disclosure and replacement system, at least get a new interest rate in place. NICO offers its assistance in your efforts.

****

ATTACHMENT THREE

To: Members of the NAIC Life Cost Disclosure Task Force, Committee (A)

From: Robert J. Lodewick, Jr.

Date: December 11, 1981

Re: Replacement Regulations

Ladies and Gentlemen:

I am Robert J. Lodewick, Jr., counsel, of Massachusetts Indemnity and Life Insurance Company. I would like to take this opportunity to recommend for your consideration the recent report by the Task Force on Life Insurance Replacement of the Illinois Insurance Department. The report was issued on October 1, 1981. Although I am certain that you have already seen the report, I will submit to you a copy of that report for your review.

I would call your attention to page 74 of the report, where it is stated that a poll of companies, conducted by the department, showed that an attempted replacements affect less than .3% of policies in force. Replacements do, in fact, constitute only a small percentage of coverages in force. As such, the question arises as to whether such transactions merit the tremendous regulatory attention paid to them. As a result of its study, therefore, this task force recommended to the Illinois Department a revised, simplified replacement regulation, requiring no comparison forms. This is the type of regulation that has recently been adopted in Mississippi and Alabama, and has been proposed for adoption in Kansas, Illinois, and Virginia. We strongly support this concept of a simplified replacement regulation. We do not think that the overly complex requirements, which are currently in effect in the majority of states, actually assist individuals in making a decision concerning the replacement of their existing coverage. They are primarily designed, in our opinion, to protect the coverage of the existing carrier, rather than to truly protect the interest of the policyholder. The policyholder's interest is best served, we would urge, by allowing him to have a more understandable opportunity to replace his existing coverage, that is, to decide whether the new coverage offered is more economical in terms of amount of protection for premium dollar. We are, after all, in an age of rapidly fluctuating inflation and interest rates, in a recessionary economy.

Our belief is substantiated in the report on page 77, where it is stated: "We believe that it is high time for some new assumptions. Namely, that individuals are responsible for their purchase decisions; and furthermore that "suitability" may be what seems right for the person who buys what he or she buys when he or she buys it. It is entirely possible that the web of regulations that currently entangle both consumers and industry could be made obsolete if these assumptions -- which we feel are the only realistic ones possible -- were substituted for the old ones."

This report makes another important point on page 77, namely: ". . . when we discuss improper or misleading sales tactics, we must make it clear that no method of marketing involving any one product, e.g., "deposit term," can by definition be an unfair market practice. Deposit term is merely a product sold by agents, just as ordinary life insurance is a product, and as yearly renewable term is a product. Opinions very greatly as to the merit of each of these, and we heard many differing opinions during the course of the hearing. We must be careful, as we have tried to point out, not to regulate to reflect opinion (don't overlook the fact that there are perhaps as many who believe whole life should be banned as harbor that prejudice about deposit term!). Each of these products may be misrepresented. Regulatory actions aimed at products would, therefore, appear to be misdirected. The products are not the problem. The problem, insofar as there is a problem, is how each of these products is sold-whenever it is sold."

We would also observe that the vast majority of complaints to insurance departments in replacement situations are made by other insurers, competitors, rather than policyholders themselves. Our company, for example, finds that we have virtually no complaints from our policyholders on the substantive coverages that we have sold them in replacement situations.

In summary, we think you would be well advised to consider recommending to the NAIC a simplified, revised replacement regulation, such as Illinois and more and more states are considering for adoption, and Mississippi and Alabama have already adopted.

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ATTACHMENT FOUR

STATEMENT ON BEHALF OF THE
AMERICAN COUNCIL OF LIFE INSURANCE
TO THE
NAIC (A) COMMITTEE'S TASK FORCE ON
LIFE INSURANCE COST DISCLOSURE

December 15, 1981

This statement is presented on behalf of the American Council of Life Insurance, whose 530 member companies account for approximately 95 percent of the total life insurance in force in this country.

We appreciate the task force's interest in receiving comments concerning cost disclosure for universal life insurance products. With any innovative product, questions arise as to whether regulation of the product can be accommodated effectively by existing statutes and regulations. The introduction of a growing variety of new life insurance plans was one of the considerations that led to the establishment of a council task force last year to review the NAIC Model Life Insurance Solicitation Regulation. That task force suggested several specific changes in the model regulation, and a copy of the task force's report was appended to the council's statement presented at your hearing in Chicago on August 11, 1981.

Since universal life insurance was then being marketed only on a very limited basis, the council task force's proposals did not address this product. The council has now developed a recommendation for universal life insurance, which we would like to present for your consideration.

The essence of the proposal is that universal life insurance be treated for cost disclosure purposes as a life insurance plan with a nonguaranteed cost element. Thus, the policy summary would show for the prescribed policy years the anticipated premiums and, both on the guaranteed and currently illustrated bases, the death benefits, cash surrender values, and endowment amounts, if any. The life insurance cost indexes would be calculated on the currently illustrated basis, using the anticipated premiums, and would be required to be shown along with corresponding nonguaranteed elements. The latter would reflect the differences between cost indexes calculated on the currently illustrated basis and cost indexes calculated on the guaranteed basis. An additional item of information that is recommended to be required in the policy summary is the point at which the policy will expire based on the policy guarantees and the anticipated premiums shown in the summary.

The council feels that these recommendations flow logically and consistently from the cost disclosure and cost comparison requirements that would be in place for other life insurance policies if the current NAIC model regulation were amended as described in our August 11 testimony. To facilitate your consideration of the council proposals, we are attaching to this statement a copy of the report of the council task force that reviewed the model regulation. As we indicated, a copy of this report was also attached (Appendix C) to our statement presented at the August 11 hearing.

We thank you for the opportunity to present our views on these important issues, and would be glad to answer any questions you may have.

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ATTACHMENT FOUR-A

TASK FORCE REPORT OF THE
SUBCOMMITTEE ON COST COMPARISONS

September 2, 1980

The purpose of this report is to recommend (1) certain clarifications in the cost disclosure applicable to special plans; and (2) introduction of a "Non-Guaranteed Element" concept into the NAIC Life Insurance Solicitation Regulation and Buyers Guide. These refinements are needed to provide fair cost disclosure for products which have emerged in recent years and which differ in some respect from the more traditional life insurance policies.

"Non-Guaranteed Element" Index (NGE)

The NGE would replace ELAD and would be determined for ten and 20 year periods. For a given period of years, the NGE would equal the difference between (1) the surrender cost index determined on the "highest possible cost" basis; and (2) the surrender cost index on the currently illustrated basis.

For traditional participating policies, the "highest possible cost" basis would assume no dividends. For "adjustable premium" non-participating policies, which contain the contractual right to decrease or increase premiums within maximum limits set forth in the policy, the "highest possible cost" basis would assume maximum premiums during any period beyond the time when the initial rate level might be guaranteed. For other special types of policies (i.e., "adjustable cash value" policies, the "highest possible cost" basis would assume minimum contractual cash values and death benefits.

One feature of the ELAD approach, incorporated in the current NAIC Model Regulation, is that it does not include terminal dividends. The NGE calculation does incorporate terminal dividends, and thus the NGE index does specifically define the non-guaranteed element of the surrender cost index.

For most plans, the NGE defines the non-guaranteed element of the payment index, as well. However, we recognize that there are some plans for which an NGE based on the payment index might differ significantly from the NGE based on the surrender cost index. As noted above, such situations now exist with ELAD under the current regulations. For these situations, an amended regulation should allow the insurer to disclose both types of NGE.

Economatic, or "EOL", type policies

For cost disclosure purposes, let us define an EOL-type policy as a participating policy which as the following characteristics for all issue ages:

1) The basic policy has a guaranteed death benefit, which reduces after an initial period of one or more years to a basic amount.

2) A special dividend option provides either (i) a combination of immediate paid-up additions and one year term insurance; or (ii) deferred paid-up additions, which on the basis of the current dividend scale will provide a combined death benefit (reduced basic death benefit, plus paid-up additions, plus one year term) at least equal to the policy's initial face amount.

In this regard, let us define "cross-over" point to mean the first policy anniversary at which the sum of the reduced basic death benefit and paid-up additions equals or exceeds the initial death benefit.

In calculating cost indexes (and NGE's) for EOL-type policies, it should be assumed that the dividends credited on or before the "cross-over" point are applied under the dividend option which produces the level death benefit, and thereafter applied to reduced premiums. Therefore, the cost indexes are not reduced by dividends due on or before the "cross-over" point, but cash values and death benefits purchased by these dividends are implicitly taken into account in the cost index calculations.

We recommend basing cost indexes for EOL-type policies on the assumption that dividends are used to reduce premiums after the "cross-over" point because:

1) this approach produces a level death benefit for the life of the policy – the basis on which the policy is usually bought

2) this approach will reduce the temptation of insurers to market EOL-type policies featuring negligible reductions in the initial death benefit, solely to take advantage of the more favorable cost indexes produced based on use of the special dividend option

With respect to the form of EOL policy using deferred paid-up additions, the "cross-over" point typically will be the policy anniversary on which the initial death benefit decreases. At that time, the deferred paid-up additions illustrated invariably will be greater than the amount needed to maintain a level death benefit. For these cases, if the cross-over point is less than 20 years from issue, the death benefit used in determining the cost indexes will not be level.

Revertible Term Policies

These policies have two premium levels. The insured is charged premiums at the lower level only if he submits satisfactory evidence of insurability at specified intervals.

For these policies, we recommend that cost indexes be disclosed as follows:

1) Cost indexes based on the assumption that the insured always qualifies for the lowest possible premium level

2. Cost indexes based on the assumption that, for all periods after the initial period, premiums are charged at the higher level

On each basis, disclosure of the NGE would be required if any element was not guaranteed. Also, a clear explanation would be required with respect to the conditions that must be fulfilled for an insured to qualify at specified intervals for lower subsequent premiums.

We recommend adoption of this disclosure approach for revertible term policies for the following two reasons:

1) The cost is not completely under the insurer's control

2) The cost can be affected by changes in the insured's health or the insurer's underwriting standards

Adjustable Cash Value Policies

These include policies under which the cash value is credited with interest at a guaranteed rate (e.g., 3.5% or 4%), plus excess interest and whose pricing reflects term rates which can be increased up to a guaranteed maximum. If these policies turn out to qualify in tax treatment as permanent life insurance -- rather than as a term plus annuity combination -- the regular life insurance cost disclosure rules should apply. This would include NGE's based on the difference between (1) cost indexes based on the guaranteed minimum interest rate and maximum term rates; and (2) cost indexes based on currently illustrated interest rates and term rates.

Also in this category are policies with face amounts and cash values geared to a high "new money" interest rate but which are not guaranteed beyond a relatively short period. For these policies, NGE's should reflect the difference between 1) cost indexes based on continuation of the initial interest rate; and 2) cost indexes based on the maximum reduction in face amount and/or cash value which might occur after the initial guaranteed period.

Multi-Track Policies

These are policies such as adjustable life or deposit term which allow the insured the option to increase or decrease the amount of insurance and/or to change or convert the plan of insurance.

For these policies, we recommend that disclosure of cost indexes be based on the assumption that the automatic option is exercised. We also recommend that an additional display of cost indexes be permitted, based on stated assumptions as to the exercise of the options.

"Term Plus Annuity" Combinations

For these cases, the two coverages may be provided by separate contracts or by a base policy together with a rider. Dropping or changing one coverage may or may not affect the other. Here, relative to cost disclosure, we recommend that the Life Insurance Solicitation Regulation be applied to the term part of the package, and the Annuity and Deposit Fund Disclosure Regulation to the other part.

It should be noted that an ACLI task force is considering the broader question of appropriate general disclosure with respect to "correlated sales" (i.e., sales of term insurance in conjunction with annuities or other savings funds). Such general disclosure requirements would be coordinated through appropriate language changes in the Life Insurance Solicitation Regulation, the Annuity and Deposit Fund Disclosure Regulation, and the Life Insurance Replacement Regulations.

Respectfully submitted,

Special Task Force of the ACLI
Cost Disclosure Subcommittee

Harold G. Ingraham, Jr., New England Life
Robert D. Lowden, John Hancock
Walter N. Miller, New York Life
Richard C. Murphy, Aetna Life and Casualty
Paul H. Rohrkemper, Connecticut General
Michael P. Tine, Travelers Insurance

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ATTACHMENT FIVE

PROPOSED REVISION OF NAIC LIFE INSURANCE SOLICITATION MODEL REGULATION

NOTE: Bracketing [ ] indicates deletion; underlining indicates new material.

Table of Contents

Section 1.	Authority
Section 2.	Purpose
Section 3.	Scope
Section 4.	Definitions
Section 5.	[Disclosure Requirements] Special Plans
Section 6.	[General Rules] Disclosure Requirements
Section 7.	[Failure to Comply] General Rules
Section 8.	[Effective Date] Failure to Comply
Section 9.	Effective Date
Appendix A	Life Insurance Buyer's Guide

Section 1. Authority.

This rule is adopted and promulgated by (title of supervisory authority) pursuant to sections (4 (1) (a) of the 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 purchasers of life insurance, information which will improve the buyer's ability to select the most appropriate plan of life insurance for his needs, improve the buyer's inderstanding 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 cost of similar plans of life insurance.

(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) Except as hereafter exempted, this regulation shall apply to any solicitation, negotiation or procurement of life insurance occurring within this state. This regulation shall apply to any issuer of life insurance contracts including fraternal benefit societies.

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

1. Annuities
2. Credit life insurance
3. Group life insurance
4. Life insurance policies issued in connection with pension and welfare plans as defined by and which are subject to the federal Employee Retirement Income Security Act of 1974 (ERISA)
5. Variable life insurance under which the death benefits and cash values vary in accordance with unit values of investments held is a separate account

Section 4. Definitions.

For the purpose of this regulation, the following definitions shall apply:

(A) [(a)] Buyer's Guide. A Buyer's Guide is a document which contains, and is limited to, the language contained in the Appendix A to this regulation or language approved by (title of supervisory authority).

(B) Cash Dividend. A [C] cash [D] dividend is the current illustrated dividend which can be applied toward payment of the gross premium.

(C) Current Rate Schedule. For a policy for which there is a non-guaranteed element, the current rate schedule shows the premiums which will be charged or the cash values, death benefits or other benefits which will be available if there is no change in the basis of these items as illustrated at the time of issue.

[(C) Equivalent Level Annual Dividend. The Equivalent Level Annual Dividend is calculated by applying the following steps:

1. Accumulate the annual cash dividends at five percent interest compounded annually to the end of the tenth and twentieth policy years.
2. Divide each accumulation of Step 1 by an interest factor that converts it into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the values in Step 1 over the respective periods stipulated in Step 1. If the period is ten years, the factor is 13.207 and if the period is 20 years, the factor is 34.719.
3. Divide the results of Step 2 by the number of thousands of the Equivalent Level Death Benefit to arrive at the Equivalent Level Annual Dividend.]

(D) Equivalent Level Death Benefit. The Equivalent Level Death Benefit of a policy or term life insurance rider is an amount calculated as follows:

1. Accumulate the [guaranteed] amount payable upon death, regardless of the cause of death, at the beginning of each policy year for ten and 20 years at five percent interest compounded annually to the end of the tenth and twentieth policy years respectively.

2. Divide each accumulation of Step 1 by an interest factor that converts it into one equivalent level annual amount that, if paid at the beginning of each year, would accrue to the value in Step 1 over the respective periods stipulated in Step 1. If the period is ten years, the factor is 13.207 and if the period is 20 years, the factor is 34.719.

(E) Enhanced Ordinary Life Policy (EOL). An Enhanced Ordinary Life Policy is a participating policy which has the following characteristics for all issue ages:

1. The basic policy has a guaranteed death benefit, which reduces after an initial period of one or more years to a basic amount, and

2. A special dividend option provides either (a) a combination of immediate paid-up additions and one year term insurance or (b) deferred paid-up additions; which on the basis of the current dividend scale will provide a combined death benefit (reduced basic amount plus paid-up additions plus one year term) at least equal to the initial face amount.

The cross-over point of an EOL policy is the first policy anniversary at which the sum of the reduced basic amount and paid-up additions equals or exceeds the initial death benefit.

(F) [(E)] Generic Name. Generic Name means a short title which is descriptive of the premium and benefit patterns of a policy or a rider.

(G) [(F)] Life Insurance Cost Indexes.

1. Life Insurance Surrender Cost Index. The Life Insurance Surrender Cost Index is calculated by applying the following steps:

a. Determine the [guaranteed] cash surrender value, if any, available at the end of the tenth and twentieth policy years.

b. For participating policies, add the terminal dividend payable upon surrender, if any, to the accumulation of the annual cash dividends at five percent interest compounded annually to the end of the period selected and add this sum to the amount determined in Step a.

c. Divide the result of Step b. (Step a. for non-participating [guaranteed-cost] policies) by an interest factor that converts it into an equivelant level annual amount that, if paid at the beginning of each year, would accrue to the value in step b. (step a. for non-participating [guaranteed cost] policies) over the respective periods stipulated in Step a. If the period is ten years, the factor is 13.207 and if the period is 20 years, the factor is 34.719.

d. Determine the equivalent level premium by accumulating each annual premium payable for the basic policy or rider at five percent interest compounded annually to the end of the period stipulated in Step a. and dividing the result by the respective factors stated in Step c. (this amount is the annual premium payable for a level premium plan).

e. Subtract the result of Step c. from Step d.

f. Divide the result of Step e. by the number of thousands of the Equivalent Level Death Benefit to arrive at the Life Insurance Surrender Cost Index.

2. Life Insurance Net Payment Cost Index. The Life Insurance Net Payment Cost Index is calculated in the same manner as the comparable Life Insurance Surrender Cost Index except that the cash surrender value and any terminal dividend are set at zero.

3. In the calculation of Life Insurance Cost Indexes for policies for which there is a non-guaranteed element, the amount payable upon death for purposes of Section 4(D)1, the cash surrender value for the purposes of Section 4(G)1., Step a., and the annual premium for the purposes of Section 4(G)1., Step d., are calculated on the basis of the Company's Current Rate Schedule.

(H) Non-Guaranteed Element. A non-guaranteed element will apply for any policy where any item entering into the calculation of the life insurance surrender cost index can be changed by the company without the consent of the policyowner. This Non-Guaranteed Element is calculated by applying the following steps.

1. Calculate the Life Insurance Surrender Cost Index for ten and 20 year periods on the assumption that the company charges the maximum premiums and pays the minimum cash values and death benefits allowed by the policy, and, if the policy is participating, pays no dividends.

2. Calculate the Life Insurance Surrender Cost Index for ten and 20 year periods on the assumption that the company charges premiums and pays cash values and death benefits on the basis of its Current Rate Schedule and, if the policy is participating, pays a terminal dividend and annual dividends on the basis of its Current Dividend Scale.

3. Subtract the results of Step 2 from the results of Step 1 to arrive at the Non-Guaranteed Element.

(I) [(G)] Policy Summary. For the purposes of this regulation, Policy Summary means a written statement describing the elements of the policy including but not limited to:

1. A prominently placed title as follows: STATEMENT OF POLICY COST AND BENEFIT INFORMATION.

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 Policy Summary.

3. 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.

4. The generic name of the basic policy and each rider.

5. The following amounts, where applicable [,] for the first five policy years and representative policy years thereafter sufficient to clearly illustrate the premium and benefit patters, including, but not necessarily limited to, the years for which Life Insurance Cost Indexes are displayed and at least one age from 60 through 65 or maturity whichever is earlier:

   a. The annual premium for the basic policy

   b. The annual premium for each optional rider

   c. The [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 by the basic policy and each optional rider, with benefits provided under the basic policy and each rider shown separately

   d. Total [guaranteed] cash surrender values at the end of the year with values shown separately for the basic policy and each rider

   e. Cash dividends payable at 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)

   f. The [guaranteed] endowment amounts payable under the policy which are not included under guaranteed cash surrender values above

   For a policy for which there is a non-guaranteed element, the maximum premium and the minimum amount payable upon death, minimum cash value and minimum endowment amounts allowed by the policy must be shown. These amounts may also be shown on the basis of the company's Current Rate Schedule.

6. The effective policy loan annual percentage interest rate, if the policy contains this provision, specifying whether this rate is applied in advance or in arrears. If the policy loan interest rate is variable, the Policy Summary includes the maximum annual percentage rate.

7. Life Insurance Cost Indexes for ten and 20 years but in no case beyond the premium paying period. Separate indexes are displayed for the basic policy and for each optional term life insurance rider. Such indexes need not be included for optional riders which are limited to benefits such as accidental death benefits, disability waiver of premium, preliminary term life insurance coverage of less than 12 months and guaranteed insurability benefits nor for the basic policies or optional riders covering more than one life.

8. The Non-Guaranteed Element] Equivalent Level Annual Dividend,] in the case of participating policies and [participating optional term life insurance riders, or other policies and riders for which there is a non-guaranteed element, under the same circumstances and for the same duration[s] at which Life Insurance Cost Indexes are displayed.

9. A Policy Summary for a participating policy, or any other policy for which there is a non-guaranteed element, shall include the following:

   a. A statement indicating which cost factor is not guaranteed and that such factor is based on the company's Current Dividend Scale or Current Rate Schedule.

   b. A statement in close proximity to the non-guaranteed element as follows: An explanation of the intended use of the non-guaranteed element is included in the Life Insurance Buyer's Guide.

   [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 in addition to a statement in close proximity to the Equivalent Level Annual Dividend as follows: An explanation of the intended use of the Equivalent Level Annual Dividend is included in the Life Insurance Buyer's Guide.]

10. A statement in close proximity to the Life Insurance Cost Indexes as follows: An explanation of the intended use of these indexes is provided in the Life Insurance Buyer's Guide.

11. The date on which the Policy Summary is prepared. The Policy Summary must considt of a separate document. All information required to be disclosed must be set out in such a manner as to not 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 five of 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.

Section 5. Special Plans.

The definitions of Section 4 will be modified as indicated below for certain special plans of insurance:

(A) Enhanced Ordinary Life Policies. In the calculation of Life Insurance Cost Indexes for and EOL policy, as defined in Section 4 (E):

   1. The cash value of benefits purchased by dividends payable on or before the cross-over point is included in the cash surrender value for the purpose of Section 4(G)1., Step a.

   2. The death benefit purchased by dividends payable on or before the cross-over point is included in the amount payable upon death for the purpose of Section 4(D)1.

   3. Dividends payable after the cross-over point are assumed to be paid in cash for the purpose of Section 4(G)1., Step b.

(B) Policies with Rates Subject to Continued Insurability. For a policy under which premiums are charged at a reduced rate if evidence of continued insurability is submitted periodically, the Policy Summary must display cost indexes and other data on the assumption, first, that the insured always qualifies for the lowest possible premium level and, second, that premiums are always charged at the highest level allowed by the policy. The Summary must indicate the conditions that must be fulfilled for an insured to qualify periodically for the lower premiums.

(C) Adjustable Cash Value Policies. For policies with cash values which are not fully guaranteed, such as

   1. A policy under which the cash value is credited with interest at a guaranteed rate plus excess interest and whose pricing reflects term rates which can be increased up to a guaranteed maximum, or

2. A policy with a death benefit and cash values based on a current interest rate which is not guaranteed beyond an initial period.

Cost indexes are calculated on the basis of premiums, cash values and death benefits according to the company's current rate schedule, and the non-guaranteed element is calculated according to the rules of Section 4(I).

(D) Multi-Track Policies. For a policy which gives the owner the option to change or convert the policy from one plan or amount to another, Life Insurance Cost Indexes and the non-guaranteed element shall be calculated, and data shall be displayed on the Policy Summary, on the assumption that the option is exercised. Indexes may also be calculated and data may also be displayed based on stated assumptions as to the exercise of the option.

Section 6 [5]. Disclosure Requirements.

(A) The insurer shall provide, to all prospective purchasers, a Buyer's Guide and a Policy Summary prior to accepting the applicant's initial premium or premium deposit, unless the policy for which application is made contains an unconditional refund provision of at least ten days or unless the Policy Summary contains such an unconditional refund offer, in which event the Buyer's Guide and Policy Summary must be delivered with the policy or prior to delivery of the policy.

(B) The insurer shall provide a Buyer's Guide and a Policy Summary to any prospective purchaser upon request.

(C) In the case of policies where the [whose] Equivalent Level Death Benefit does not exceed $5,000, the requirement for providing a Policy Summary will be satisfied by delivery of a written statement containing the information described in Section 4(I) [(G)], items 2, 3, 4, 5a, 5b, 5c, 6, 7, 8, 9, 10 and [,] 11.

Section 7[6]. General Rules.

(A) Each insurer shall maintain at its home office or principal office, a complete file containing one copy of each document used by it authorized [by the insurer for use] pursuant to this regulation. Such file shall contain one copy of each authorized form for a period of three years following the date of its last authorized use.

(B) An agent shall inform the prospective purchaser, prior to commencing a life insurance sales presentation, that he is acting as a life insurance agent and inform the prospective purchaser of the full name of the insurance company which he 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 primarily [generally] engaged in an advisory business in which compensation is unrelated to sales unless such is actually the case.

(D) Any reference to a [policy] dividend[s] or other Non-Guaranteed Cost Factor must include a statement that such factor is [dividends are] not guaranteed[.] and is based on the company's current dividend scale or current rate schedule.

(E) A system or presentation which does not recognize the time value of money through the use of appropriate interest adjustments shall not be used for comparing the cost of two or more life insurance policies. Such a system may be used for the purpose of demonstrating the cash-flow pattern of a policy if such presentation is accompanied by a statement disclosing that the presentation does not recognize that, because of interest, a dollar in the future has less value than a dollar today.

(F) A presentation of costs (other than Life Insurance Cost Indexes) or benefits shall not display guaranteed and non-guaranteed factors [benefits] as a single sum unless they are shown separately in close proximity thereto.

(G) A statement regarding the use of the Life Insurance Cost Indexes shall include an explanation to the effect that the indexes are useful only for the comparison of the relative costs of two or more similar policies.

(H) A Life Insurance Cost Index which reflects a non-guaranteed element [dividends or an Equivalent Level Annual Dividend] shall be accompanied by a statement that it is based on the company's current [dividend] scale or schedule for that factor and is not guaranteed.

[(I) For the purposes of this regulation, the annual premium for a basic policy or rider, for which the company reserves the right to change the premium, shall be the maximum annual premium.]

Section 8 [7]. Failure to Comply.

Failure of an insurer to provide or deliver a Buyer's Guide, or a Policy Summary as provided in Section 6 [5] shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an insurance policy.

Section 9 [8]. Effective Date.

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

APPENDIX A

Life Insurance Buyer's Guide

The face page of the Buyer's Guide shall read as follows:

Life Insurance Buyer's Guide

This guide can show you how to save money when you shop for life insurance. It helps you to:
- Decide how much life insurance you should buy
- Decide what kind of life insurance policy you need
- Compare the cost of similar life insurance policies

Prepared by the National Association of Insurance Commissioners

Reprinted by (Company Name)

(Month and year of printing)

The Buyer's Guide shall contain the following language at the bottom of page 2:

The National Association of Insurance Commissioners is an association of state insurance regulatory officials. This association helps the various insurance departments to coordinate insurance laws for the benefit of all consumers. You are urged to use this guide in making a life insurance purchase.

This Guide Does Not Endorse Any Company or Policy

The remaining text of the Buyer's Guide shall begin on page 3 as follows:

Buying Life Insurance

When you buy life insurance, you want a policy which fits your needs without costing too much. Your first step is to decide how much you need, how much you can afford to pay and the kind of policy you want. Then, find out what various companies charge for that kind of policy. You can find important differences in the cost of life insurance by using the life insurance cost indexes which are described in this guide. A good life insurance agent or company will be able and willing to help you with each of these shopping steps.

If you are going to make a good choice when you buy life insurance, you need to understand which kinds are available. If one kind does not seem to fit your needs, ask about the other kinds which are described in this guide. If you feel that you need more information than is given here, you may want to check with a life insurance agent or company or books on life insurance in your public library.

Choosing the Amount

One way to decide how much life insurance you need is to figure how much cash and income your dependents would need if you were to die. You should think of life insurance as a source of cash needed for expenses of final illness, paying taxes, mortgages or other debts. It can also provide income for your family's living expenses, educational costs and other future expenses. Your new policy should come as close as you can afford to making up the difference between (1) what your dependents would have if you were to die now, and (2) what they would actually need.

Choosing the Right Kind

All life insurance policies agree to pay an amount of money if you die. But all policies are not the same. There are three basic kinds of life insurance:

1. Term insurance
2. Whole life insurance
3. Endowment insurance

Remember, no matter how fancy policy title or sales presentation might appear, all life insurance policies contain one or more of the three basic kinds. If you are confused about a policy that sounds complicated, as the agent or company if it combines more than one kind of life insurance. The following is a brief description of the three basic kinds:

Term Insurance

Term Insurance is death protection for a "term" of one or more years. Death benefits will be paid only if you die within that term of years. Term insurance generally provides the largest immediate death protection for your premium dollar.

Some term insurance policies are "renewable" for one or more additional terms even if your health has changed. Each time you renew the policy for a new term, premiums will be higher. You should check the premiums at older ages and the length of time the policy can be continued.

Some term insurance policies are also "convertible". This means that before the end of the conversion period, you may trade the term policy for a whole life or endowment insurance policy even if you are not in good health. Premiums for the new policy will be higher than you have been paying for the term insurance.

Whole Life Insurance

Whole life insurance gives death protection for as long as you live. The most common type is called "straight life" or "ordinary life" insurance, for which you pay the same premiums for as long as you live. These premiums can be several times higher than you would pay initially for the same amount of term insurance. But they are smaller than the premiums you would eventually pay if you were to keep renewing a term insurance policy until your later years.

Some whole life policies let you pay premiums for a shorter period such as 20 years, or until age 65. Premiums for these policies develop "cash values" which you may have if you stop paying premiums. You can generally either take the cash, or use it to buy some continuing insurance protection. Technically speaking, these values are called "nonforfeiture benefits." This refers to benefits you do not lose (or "forfeit") when you stop paying premiums. The amount of these benefits depends on the kind of policy you have, its size, and how long you have owned it.

A policy with cash values may also be used as collateral for a loan. If you borrow from the life insurance company, the rate of interest is shown in your policy. Any money which you owe on a policy loan would be deducted from the benefits if you were to die, or from the cash value if you were to stop paying premiums.

Endowment Insurance

An endowment insurance policy pays a sum or income to you — the policyholder — if you live to a certain age. If you were to die before then, the death benefit would be paid to your beneficiary. Premiums and cash values for endowment insurance are higher than for the same amount of whole life insurance. Thus endowment insurance gives you the least amount of death protection for your premium dollar.

Finding a Low Cost Policy

After you have decided which kind of life insurance fits your needs, look for a good buy. Your chances of finding a good buy are better if you use two types of index numbers that have been developed to aid in shopping for life insurance. One is called the "Surrender Cost Index" and the other is the "Net Payment Cost Index". It will be worth your time to try to understand how these indexes are used, but in any event, use them only for comparing the relative costs of similar policies. LOOK FOR POLICIES WITH LOW COST INDEX NUMBERS.

What is Cost?

"Cost" is the difference between what you pay and what you get back. If you pay a premium for life insurance and get nothing back, your cost for the death protection is the premium. If you pay a premium and get something back later on, such as a cash value, your cost is smaller than the premium.

The cost of some policies can also be reduced by dividends; these are called "participating" policies. Companies may tell you what their current dividends are, but the size of future dividends is unknown today and cannot be guaranteed. Dividends actually paid are set each year by the company.

Policies which do not pay dividends are called "non-participating." Under some non-participating policies, premiums, cash values and death benefits are guaranteed; [Some policies do not pay dividends. T] these are called "guaranteed cost" [or "non-participating"] policies. Every feature of a guaranteed cost policy is fixed so that you know in advance what your future costs will be.

Some policies do not guarantee the amount of the premium which will be charged or the amount of the cash value or death benefit which will be paid. When one or more of these features is not guaranteed, companies may tell you the amount of the non-guaranteed features on the basis of their current rates but the actual amounts charged or paid may be more or less than their current rates.

[The premiums and cash values of a participating policy are guaranteed, but the dividends are not.] Premiums for participating policies are typically higher than for guaranteed cost policies, but the cost to you over time may be higher or lower, depending on the dividends actually paid [.] under the participating policy. Costs of other policies with non-guaranteed costs will also depend on the premiums actually charged or the cash values or death benefits actually paid.

What are Cost Indexes?

In order to compare the cost of policies, you need to look at:

1. Premiums
2. Cash values
3. Dividends

Cost indexes use one or more of these factors to give you a convenient way to compare relative costs of similar policies. When you compare costs, an adjustment must be made to take into account that money is paid and received at different times. It is not enough to just add up the premiums you will pay and to subtract the cash values and dividends you expect to get back. These indexes take care of the arithmetic for you. Instead of having to add, subtract, multiply, and divide many numbers yourself, you just compare the index numbers which you can get from life insurance agents and companies:

1. Life Insurance Surrender Cost Index. This index is useful if you consider the level of the cash values to be of primary importance to you. It helps you compare costs if at some future point in time, such as ten or 20 years, you were to surrender the policy and take its cash value.

2. Life Insurance Net Payment Cost Index. This index is useful if your main concern is the benefits that are to be paid at your death and if the level of cash values is of secondary importance to you. It helps you compare costs at some future point in time, such as ten or 20 years, if you continue paying premiums on your policy and do not take its cash value.

There is another number called the Non-Guaranteed Element [Equivalent Level Annual Dividend]. [It shows the part dividends play in determining the cost index of a participating policy.] For participating policies, this number shows the effect on the cost indexes of dividends. Under other policies, this number shows the effect on cost indexes of any portion of premiums, cash values or death benefits which is not guaranteed. Adding a policy's non-guaranteed element [Equivalent Level Annual Dividend] to its cost index allows you to compare maximum [total] costs of similar policies [before deducting dividends]. However, in making such comparisons [if you make any cost comparisons of a participating policy with a non-participating policy], remember that the maximum [total] cost of a [the participating policy for which a non-guaranteed element is shown may [will] be reduced [by dividends], but the cost of a guaranteed cost [the non-participating] policy will not change.

How Do I Use Cost Indexes?

The most important thing to remember when using cost indexes is that a policy with a small index number is generally a better buy than a comparable policy with a larger index number. The following rules are also important:

1. Cost comparisons should only be made between similar plans of life insurance. Similar plans are those which provide essentially the same basic benefits and require premium payments for approximately the same period of time. The closer policies are to being identical, the more reliable the cost comparison will be.

2. Compare index numbers only for the kind of policy, for your age and for the amount you intend to buy. Since no one company offers the lowest cost for all types of insurance at all ages and for all amounts of insurance, it is important that you get the indexes for the actual policy, age and amount which you intend to buy. Just because a "Shopper's Guide" tells you that one company's policy is a good buy for a particular age and amount, you should not assume that all of that company's policies are equally good buys.

3. Small differences in index numbers could be offset by other policy features, or differences in the quality of service you may expect from the company or its agent. Therefore, when you find small differences in cost indexes, your choice should be based on something other than cost.

4. In any event, you will need other information on which to base your purchase decision. Be sure you can afford the premiums, and that you understand its cash values, dividends and death benefits. You should also make a judgment on how well the life insurance company or agent will provide service in the future, to you as a policyholder.

5. These life insurance cost indexes apply to new policies and should not be used to determine whether you should drop a policy you have already owned for awhile, in favor of a new one. If such a replacement is suggested, you should ask for information from the company which issued the old policy before you take action.

Important Things to Remember – A Summary

The first decision you must make when buying a life insurance policy is choosing a policy whose benefits and premiums most closely meet your needs and ability to pay. Next, find a policy which is also a relatively good buy. If you compare Surrender Cost Indexes and Net Payment Cost Indexes of similar competing policies, your chances of finding a relatively good buy will be better than if you do not shop. REMEMBER, LOOK FOR POLICIES WITH LOWER COST INDEX NUMBERS. A good life insurance agent can help you to choose the amount of life insurance and kind of policy you want and will give you cost indexes so that you make cost comparisons of similar policies.

Don't buy life insurance unless you intend to stick with it. A policy which is a good buy when held for 20 years can be very costly if you quit during the early years of the policy. If you surrender such a policy during the first few years, you may get little or nothing back and much of your premium may have been used for company expenses.

Read your new policy carefully, and ask the agent or company for an explanation of anything you do not understand. Whatever you decide now, it is important to review your life insurance program every few years to keep up with changes in your income and responsibilities.

MANIPULATION, LAPSATION, DIVIDEND PRACTICES, AND ANNUITY DISCLOSURE (A) TASK FORCE

Reference: Formerly part of Life Insurance (C3) Subcommittee
1981 Proc. I p. 515
1981 Proc. II p. 643

Patsy Redmond, Chairman – Nevada
Don H. Miller, Vice-Chairman – Indiana

AGENDA

1. Any matters brought before the task force.

CONTENTS

December, 1981 report. 412
Report of the Annuity Disclosure Advisory Committee (Attachment One) 413
Proposed Model Annuity and Deposit Fund Disclosure Regulation (Attachment One-A) 414
Proposed Buyer's Guide to Annuities (Attachment One-B) 418
Report of the Committee on Dividend Principles and Practices (Attachment Two) 421
Recommendations of the Committee on Dividend Principles and Practices (Attachment Two-A). 423

The Manipulation, Lapsation, Dividend Practices, and Annuity Disclosure (A) Task Force met in the Grand Ballroom B of the New Orleans Hilton Hotel in New Orleans, Louisiana at 9:00 a.m. on December 16. A quorum was present consisting of staff from the following states: California, Indiana, Nevada, New Jersey, and Texas. Erma Edwards, Nevada, chaired the meeting.

1. The first item on the agenda was a report from Mr. William Snell, chairman of the Annuity Disclosure Advisory Committee. He submitted a report to the task force, proposing amendments to the current Model Annuity and Deposit Fund Disclosure Regulation, including a Buyers Guide. A copy of the report is attached (Attachment One).

   Mr. Snell suggested holding a public hearing on the amendments and the Buyers Guide, after the task force has reviewed this material. This hearing will be held in conjunction with the NAIC spring meeting in Oklahoma City. Additional comments and recommendations by the task force will be made known well in advance of this public hearing.

   There was a motion made to receive the amendments and Buyers Guide; the motion was seconded and accepted.

2. The final recommendations of the Manipulation Advisory Committee and the Dividend Practices Committee were received by the task force at the June 1981 meeting. They are included in Volume II of the June 1981 Proceedings on pages 739 and 732 respectively. Both of these reports contain recommended amendments to the Life Insurance Solicitation Regulations. They were distributed to the Cost Disclosure Task Force at its December 15 meeting.

The Dividend Practices Committee report also contains recommendations for amendments to Schedule M of the annual statement. The task force voted to consider this topic at the Oklahoma City meeting. A copy of the background report of the Dividend Practices Committee is attached to this report (Attachment Two). Since several of the task force members are new, it was suggested that they review the proposed disclosure system and report of the Lapsation Advisory Committee included on page 648 of Volume II of the June 1981 Proceedings. It is expected that the task force will take action on the Lapsation Report at the June 1982 meeting.

3. The task force respectfully requests that its name be changed to Annuity Disclosure Task Force in order to more accurately reflect its activities. *[Editor's Note – The request for a name change was rejected by the Life Insurance (A) Committee. See p. 344]*

Having no further business, the task force adjourned at 9:25 a.m.

Patsy Redmond, Chairman, Nevada; Don H. Miller, Vice-Chairman, Indiana; Robert C. Quinn, California; Sherman A. Bernard, Louisiana; James J. Sheeran, New Jersey; Albert B. Lewis, New York; Lyndon L. Olson, Jr., Texas.

ATTACHMENT ONE

The Northwestern Mutual Life Insurance Company
720 East Wisconsin Avenue
Milwaukee, Wisconsin 53202

REPORT OF THE ANNUITY ADVISORY COMMITTEE

December 16, 1981

The Annuity Advisory Committee has completed work on a proposed modification of the current Model Annuity and Deposit Fund Disclosure Regulation.

We recommend that the following changes be made in the model:

1. A Buyer's Guide to Annuities be required, to explain to the prospect what an annuity is, and what it is not.

2. A revised Contract summary, stressing both monthly income and the yield on gross premiums. As before, the monthly income would be on both a guaranteed and current basis. Likewise, the yield would be on the guaranteed and current basis used for determining cash surrender values.

3. The durations have been modified slightly, to the first ten years, the twentieth year, and one year between attained ages 60 to 70.

4. A listing of loading and surrender charges is required on the Contract Summary.

5. The interest rates, both guaranteed and nonguaranteed, must be shown on the Contract Summary.

Other points I would like to emphasize are:

1. No prescribed format is suggested which is true of both the current model and the life solicitation regulation.

2. Guaranteed and nonguaranteed values must be shown in close proximity.

3. If there are nonguaranteed values, a statement to this effect must be on the Contract Summary.

4. If there is a ten day free look, both the Buyer's Guide and the Contract Summary can be delivered with the policy. However, they are also available earlier on request by the proposed annuitant.

We developed the Buyer's Guide with the intent that it would generally describe the types of annuities and deposit funds that are currently being sold in the market place. However, it does concentrate on fixed dollar, deferred annuities. We do not believe a Buyer's Guide should be required for variable annuities that are regulated by the federal government, nor for immediate annuities where the first payment commences within 13 months after sale of the contract. These are explained in the Buyer's Guide only to complete the picture of the types of annuities that are available.

As the next step, we suggest that you expose this to the appropriate commissioners and industry members, with a view that a public hearing would be held on this regulation at some time convenient to your task force.

I have discussed our proposed regulation with Mr. James Brown of the Wisconsin Consumer League, and he believes that our deliberations resulted in a proposed regulation that is an improvement over what we now have.

As chairman of the committee, I would like to thank each member of our group for the time and effort that they expended in this endeavor.

For the record their names are: Mr. Andrew Stiglitz, Connecticut General Life Insurance Company, (passed away in the Spring of 1981); Mr. Greg Carney, Anchor National Life Insurance Company; Mr. William Feeney, Equitable Life Assurance Society; Mr. Warren Carter, Teachers Insurance and Annuity Association; Mr. Fred Jonske, Allstate Life Insurance Company; Mr. Carl Meier, National Life and Accident Company; Mr. Robert Kelly, IDS Life Insurance Company. In addition, Mr. Anthony Spano of the ACLI participated in our meetings, although not a member of the committee.

William M. Snell, F.S.A., chairman
Northwestern Mutual Life Insurance

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ATTACHMENT ONE-A

MODEL ANNUITY AND DEPOSIT FUND DISCLOSURE REGULATION

(As proposed December 1981 by NAIC Advisory Committee on Annuity Disclosure)

Basic text is that adopted by NAIC, June 1978 and modified December 1979.
New material is underlined. Bracketed material is deleted.

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 and group annuities other than contracts exempted by Section 3 C below.

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. Individual deferred annuity contracts and group annuity contracts which are: (a) variable annuities; (b) [investment annuities; (c)] contracts registered with the Federal Securities and Exchange Commission; [d] (c) contracts which have variable annuity features available at the option of the contract owner.

2. 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.

3. Immediate annuity contracts.

4. 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.

5. Individual retirement accounts and individual retirement annuities as described in section 408 of the federal Internal Revenue Code.

6. A single advance payment of specific premiums equal to the discounted value of such premiums.

7. 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.

<u>Section 4. Buyer's Guide to Annuities</u>

<u>For purposes of this regulation, "Buyer's Guide to Annuities" means the document which contains, and is limited to, the language set forth in the Appendix to this regulation or language approved by (state regulatory authority).</u>

Section [4] <u>5.</u> Contract Summary

A. [The] <u>For</u> 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"] "Contract Summary." (This shall be followed by an indentification of the annuity contract or deposit fund, or both, to which the [statement] summary 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.]

4. One of the options under the contract available for annuity payout. This form of annuity payout should be used for providing information in 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 [ths] 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] ten contract years and representative contract years thereafter sufficient to clearly illustrate the patterns of considerations and benefits, including but no limited to, the [tenth and] twentieth contract [years] year and at least one age from 60-[65 or] 70 and at 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 death benefit and 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] death benefit and cash surrender value or paid-up annuity at the end ofthe 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. A statement of all fees, charges, and loading amounts that are or may be deducted from initial or subsequent considerations paid or that are or may be deducted from the contract or fund values prior to or at contract maturity, including but not limited to any surrender penalties, discontinuance fees, partial surrender or withdrawal penalties or fees, transaction fees, and account maintenance fees.

12. A statement of the interest rates used in calculating the guaranteed and illustrative contract or fund values.

13. The yield on gross considerations at the end of 10 years (if the annuity payments have not yet commenced) and at the scheduled commencement of annuity payments. These yield figures shall be shown on both a guaranteed and illustrative basis. They represent the effective annual interest rates at which the accumulation of 100% of all gross considerations would be equal to the guaranteed and illustrative cash surrender values at the points specified. For contracts without surrender values the yields shall be figured on the basis of the contract values used to determine annuity payments at the points specified.

[11]. 14. 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, and 13 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 $100 a month or $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] 6. Disclosure Requirements

A. The insurer shall provide to all prospective purchasers a Buyer's Guide to Annuities and 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 Buyer's Guide to Annuities and 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 Buyer's Guide to Annuities and a Contract Summary to any prospective purchaser upon request.

Section [6] 7. 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 excess interest 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 saving institutions. The use of passbooks which resemble saving bank passbooks is prohibited.

Section [7] 8. Failure to Comply

Failure of an insurer to provide or deliver a Buyer's Guide to Annuities and a Contract Summary as provided in section [5] 6 shall constitute an omission which misrepresents the benefits, advantages, conditions or terms of an annuity contract or of an insurance policy.

Section [8] 9. 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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ATTACHMENT ONE-B

[Editor's Note — Attachment One-B is the text of the proposed Buyer's Guide to Annuities.]

WHAT IS AN ANNUITY?

An annuity is a series of payments made at regular intervals. You can buy annuity contracts from life insurance companies. In return for premiums that you pay, the company will pay you an annuity. The main reason to buy an annuity contract is to obtain an income, usually for retirement purposes. An annuity contract is not a life insurance policy or a health insurance policy. It is not a savings account or savings certificate, nor should it be bought as a short term investment.

TYPES OF ANNUITY CONTRACTS

Annuity contracts may be classified in a number of ways. The most common classifications are set out below.

Annuity contracts may be either immediate or deferred. Immediate annuity contracts provide income payments that start shortly after you pay the premium. Deferred annuity contracts provide income payments that start later, often many years later.

Annuity contracts may be either single premium or installment premium. Single premium contracts require you to pay the company only one premium. Installment premium contracts are designed for a series of premiums. Most of these are flexible premium contracts; they allow you to pay as much as you wish whenever you wish, within specified limits. Others are scheduled premium contracts, which specify the size and frequency of your premiums.

Annuity contracts may be either individual or group. Individual contracts cover only one or two persons. Group contracts cover a specified group of people.

Annuity contracts may be fixed, variable, or a combination of both. During the deferred period of a fixed annuity contract, premiums (less charges) are accumulated at rates of interest set by the company. The amount of each annuity payment is determined when payments begin. During the deferred period of a variable annuity, the value of the accumulated premiums (less charges) varies with the performance of a specified pool of investments. The amount of annuity payments also varies with the performance of the pool. Combination annuities allow you to put part of your premium in a fixed annuity and part in a variable annuity.

Some companies offer deposit fund arrangements under the provisions of their life insurance policies or annuity contracts. These arrangements allow you to pay amounts, in addition to your premiums, which will be accumulated at interest in much the same way as under a deferred fixed annuity contract. The balance of this Buyer's Guide deals specifically with deferred fixed annuity contracts and, therefore, is generally applicable to deposit fund arrangements also.

ANNUITY CONTRACT FEATURES

Your value in the contract consists of the premiums you have paid, less charges, plus interest credited. This value is used to calculate the amount of most benefits that you will receive. Charges, interest, and benefits are explained below.

CHARGES

Considerable diversity exists in the types and amounts of charges. A typical contract might contain one or more of the following types of charges. Companies may refer to these charges by different names.

Percentage of Premium Charge. This charge, often called a "load," is deducted from each premium paid. The percentage may reduce after the contract has been in force for a certain number of years or after total premiums paid have reached a certain level.

Contract Fee. This is a flat dollar amount charged either once at issue or annually.

Transaction Fee. This is a charge per premium payment or other transaction.

Surrender Charge. This charge is usually a percentage of the value of the contract or of premiums paid. The percentage may be reduced or eliminated after the contract has been in force for a certain number of years. Sometimes the charge takes the form of a reduction in the interest rate credited. In some cases, the charge is eliminated if the interest rate declared by the company falls below a certain level.

INTEREST

The interest rate used to accumulate contract values may never be less than the guaranteed rate stated in the contract. In practice, the interest rate actually used by a company, usually referred to as the "current" rate, is often higher. The company may change the current rate from time to time, but it cannot be lower than the guaranteed rate. Companies differ substantially in their methods of determining the current rate.

BENEFITS

Annuity contracts provide a number of benefits. While the annuity income benefit is the primary one, the other benefits set out below are also important.

ANNUITY INCOME BENEFIT

Income payments are usually made monthly, although other frequencies are available. The amount of the annuity payments is based on both the value of the contract and the contract's "benefit rate" when annuity payments begin. This benefit rate depends on your age and sex, and the annuity form you have chosen.

Annuity contracts contain a table of guaranteed benefit rates. Most companies periodically develop "current" benefit rates as well; these rates are subject to change by the company at any time. When annuity payments begin, the company will determine the amount of each payment according to the current benefit rates then in effect if these are more favorable to you. If the guaranteed benefit rates would provide higher income payments, those rates will be used. Once payments begin, they are unaffected by any future benefit rate changes.

The most commonly available annuity forms are:

Straight Life. The annuity is paid as long as you are alive. There are no further payments to anyone after your death.

Life With Period Certain. The annuity is paid as long as you are alive. If you die before the end of the period referred to as the "certain period," the annuity will be paid to your beneficiary for the rest of that period. Typical certain periods are 10 or 20 years.

Joint and Survivor. The annuity is paid as long as either you or another named annuitant is still alive. In some variations, the annuity is decreased after the first death. A period certain may also be available with this form.

DEATH BENEFIT

Most contracts provide that, if you die before the annuity payments start, the contract value will be paid to your beneficiary. Some contracts provide that the death benefit will be the total premiums paid if that amount is greater than the value of the contract at death.

SURRENDER BENEFIT

Most annuity contracts allow you to surrender your contract if income payments have not yet started. Upon surrender, the contract terminates. The surrender benefit is equal to your contract value less surrender charge, if any.

Many annuity contracts also provide that you may withdraw a portion of your contract value, under certain conditions, without terminating the contract. A surrender charge may be deducted from the amount withdrawn.

WAIVER OF PREMIUM BENEFIT

Some companies offer a benefit which will pay premiums for you if you become disabled. A charge is made for this benefit.

HOW MUCH SHOULD I BUY?

Before buying, ask yourself these questions:

1. How much annuity income will I need in addition to social security, pensions savings, and investments?

2. Will I need an income only for myself or for someone else also?

3. How much can I afford to pay in premiums?

4. How will the annuity contract fit in with my total financial planning?

HOW TO BUY AN ANNUITY

Buying an annuity contract is a major financial decision which should be considered carefully.

CONTRACT SUMMARY

You will receive a Contract Summary when an annuity contract is delivered to you, or you can ask for one now. You should review this statement thoroughly.

Assumulated values and surrender values under the contract are illustrated for various years on this statement. During the first few years, these values may be less than premiums paid. This is why an annuity contract should not be purchased as a short term investment.

Also illustrated is the yield on gross premium at the end of 10 years and at the time income payments are scheduled to begin. Since it takes into account not only the interest credited under the contract, but also the effect of all charges, the yield on gross premiums is a figure you can use to compare annuity contracts. Be careful in comparing this figure with yields available on investments. The tax treatment of annuity earnings is usually substantially different from that of earnings from investments. Also only annuity contracts offer life income and waiver of premium benefits.

As stated at the beginning of this guide, the main reason to buy an annuity contract is to obtain an income. Therefore, you should also review the life income figures shown in the Contract Summary.

You will note that all values and income figures are shown on both a "guaranteed" and a "current" basis. Illustrations on the guaranteed basis show the minimum values and income which could be paid under the contract. Illustrations on the current basis show the values and income which would be paid if the current interest and benefit rates for the contract were to continue in effect for the period shown. Since it is impossible to predict the future course of interest and benefit rates, you will have to decide for yourself how much to rely on the current basis values when making your purchase decision.

OTHER POINTS TO CONSIDER

Be certain that you understand the effect of all charges that will be made under the contract.

Check whether the annuity contract allows you to change the amount of your premium payments. Find out what happens if you stop paying premiums altogether.

You may want to obtain and compare Contract Summaries for similar contracts from several companies. Comparing these should help you select a good buy.

If you are buying an annuity contract for an Individual Retirement Account (IRA) or another tax deferred retirement program, make sure that you are eligible. Also, make sure that you understand any restrictions connected with the program.

If you are shown a presentation which illustrates tax savings, find out what assumptions are used. Be sure the assumptions apply in your case.

A good agent can help you choose the right annuity contract. Remember that the quality of service that you can expect from the life insurance company and the agent is an important factor also.

READ THE CONTRACT

When you receive your new annuity contract, read it carefully. Ask the agent and company for an explanation of anything you do not understand.

If you have a specific complaint or cannot get the answers you need from the agent or company, please contact your state insurance department.

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ATTACHMENT TWO

American Academy of Actuaries
1835 K Street, N.W.
Suite 515
Washington, D.C. 20006
(202) 223-8196

December 10, 1981

Report: To the NAIC Subcommittee on Manipulation, Dividends, and Lapsation

From: Committee on Dividend Principles and Practices

The purpose of this report is to provide the subcommittee with background information with respect to the work of the committee on Dividend Principles and Practices and its current activities.

The Committee on Dividend Principles and Practices was formed in December, 1978 in order to deal with issues emerging with respect to both the determination of dividends to existing policyholders and the illustration of dividends to prospective and existing policyholders. With respect to dividends determined for existing policyholders, there was a need to provide for standards of practice which would support the equitable distribution of dividends among classes of policyholders. With respect to dividend illustrations, there was a need to assure for purposes of cost comparison among companies that dividend illustrations reflected the company's current ability to pay dividends, so that competitive cost comparisons which were based upon dividend illustrations could be useful in comparing competitive price performance.

In October 1980, the American Academy of Actuaries adopted Recommendations Concerning Principles and Practices in Connection with Dividend Determination and Illustration by mutual life insurance companies. Copies of these principles and practices, similar to the one attached, have been previously distributed to the subcommittee.

These principles and practices provide that the actuary who recommends a dividend scale to his company must furnish with that recommendation a report which identifies the manner in which the dividend recommendation has followed these principles and practices. It also must highlight any deviations from these principles and practices. And, the actuary must be prepared to defend them.

The committee on Dividend Principles and Practices recognizes that while the recommendations define the actuary's responsibilities, they cannot by themselves guarantee either equitable treatment of policyholders with respect to dividends paid or comparable dividend illustrations. In its report to this subcommittee in June, 1981, the committee suggested a procedure through which the NAIC could make use of the existence of the actuary's report to achieve these ends. The committee suggested a modification of Schedule M of the Annual Statement which would summarize the relevant material from the actuary's report, highlight deviations from the Recommended Principles and Practices and highlight the results of dividend scale changes. Suggested language for the actuary's certification of adherence to the recommended principles and practices is also provided.

In addition, recommended language was suggested for the purpose of approaching a reasonable level of comparability of cost illustration. Suggestions were made with respect to modifications of the Buyer's Guide and of information to the company dividend illustrations. The text for each company's illustrations would depend upon the responses made in Schedule M.

The NAIC accepted the report for exposure in June of 1981. The Committee on Dividend Principles and Practices stands ready to assist the NAIC in its consideration of the suggested modifications to the Annual Statement and to cost disclosure regulations.

The committee would like to emphasize the fact that in order for the consumer disclosure portion of its suggestions to be effective, the suggested changes to the Annual Statement must also be made, since the consumer disclosure language relies upon disclosure in the Annual Statement.

At the present time, the Society of Actuaries Committee on the Theory of Dividends and Other Nonguaranteed Elements of Pricing has been at work in extending a framework for similar principles and practices, both to dividends for policies issued by stock life companies and to other elements of nonguaranteed pricing. Such elements would include those inherent in products known as "indeterminate premium" policies and "universal life" policies. When this work is completed, the academy committee will take whatever steps are necessary to establish appropriate recommended principles and practices and to make suggestions which are parallel to those for dividends for policies issued by mutual companies.

Because of the emerging nature of principles and practices in some of these areas, the process of establishing appropriate recommendations will be lengthy and time-consuming. The committee believes it is important for the NAIC to proceed with the issues involving mutual company dividends without waiting for the elements now under consideration.

Respectfully submitted,

John H. Harding, chairman
Committee on Dividend Principles
and Practices

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ATTACHMENT TWO-A

RECOMMENDATIONS OF THE COMMITTEE ON
DIVIDEND PRINCIPLES AND PRACTICES

Adopted by the
Board of Directors
American Academy of Actuaries

October 31, 1980

Resolution Concerning Dividend Principles and Practices

At a duly convened meeting of the board of directors of the American Academy of Actuaries on October 31, 1980 the following resolution was adopted:

1. The board of directors adopts the Recommendations Concerning Actuarial Principles and Practices in Connection with Dividend Determination and Illustration for Individual Life Insurance Issued by Mutual Companies, as amended by the Committee on Dividend Principles and Practices subsequent to the June 1980 exposure draft.

2. Pursuant to Guides to Professional Conduct 4(b) and 4(c), it is the opinion of the board of directors that an actuary should take into consideration these recommendations. An actuary who uses principles or practices which differ materially from these recommendations must be prepared to support his or her particular use of such principles and practices and should include in his or her actuarial report appropriate and explicit information with respect to the principles and practices he or she has used.

Recommendations Concerning Actuarial Principles and Practices in Connection with Dividend Determination and Illustration for Individual Life Insurance Issued by Mutual Companies

Section 1. General

1.1 These recommendations describe the basic responsibilities of the actuary in the application of sound actuarial principles and practices to the determination of dividends under individual life insurance policies.

1.2 These recommendations apply to dividends distributed under the provisions of participating policies issued in the United States by a mutual life insurance company.

1.3 The determination of the aggregate amount of dividends to be distributed in any year is a decision to be made by company management in light of many factors, the most significant being the continuing solvency of the company and its ability to fulfill all contractual obligations. This determination is not the subject of these recommendations.

1.4 These recommendations address both the determination of currently payable dividends for policies in force and the closely related process of determining illustrated future dividends for both in-force business and new business.

1.5 Opinion A-3. Transmittal of Actuarial Reports, includes the following statements:

(a) "An actuarial report is essentially a statement of actuarial findings, conclusions or recommendations resulting from the actuary's experience and judgment, applied within the framework of a particular set of facts and assumptions."

(b) "Any manner of transmittal of an actuarial report, prepared by an actuary, which involves the risk that the underlying facts and assumptions, and the limitations resulting from their use, are not fully communicated to the client involves a corresponding risk that the conclusions or recommendations may be misinterpreted or misapplied. It is important, therefore, that this risk be minimized or eliminated."

(c) "When an actuary advises an insurance company on premiums, dividends, reserves and related matters, the client is the company, its policy-making executives and in some situations its board of directors and it auditors, whether or not he is an employee of the insurance company."

Consequently, these recommendations elaborate on the requirements expressed in Opinion A-3 and the more general provision of the Guides to Professional Conduct, particularly Guides 2c, 4a and 4b.

1.6 RECOMMENDATION 1: Whenever an actuary advises an insurance company on dividends, either illustrated dividends, he or she should prepare a written report which documents the advice. Such a report should include a statement describing the framework of facts, assumptions and procedures upon which the advice was based. In particular, if an actuary uses assumptions and procedures which deviate materially from those prescribed in these Recommendations, he or she should support the use of such assumptions and procedures and should include in the report an appropriate and explicit statement with respect to the nature, rationale and effect of such deviations.

1.7 "Sound actuarial principles" emerge from the utilization and adaptation of generally accepted concepts described in actuarial literature. Such literature includes the Recommendations and Interpretations of the American Academy of Actuaries, Canadian Institute of Actuaries and recognized actuarial testbooks. The study notes for candidates for fellowship in the Society of Actuaries are also valuable parts of the literature, but it should be kept in mind that the study notes are intended primarily to teach basic principles rather than to specify professional conduct. Furthermore, the professional journals of the Society of Actuaries and its predecessors provide an additional source for the presentation and discussion of actuarial principles and practices. It must also be noted that use of certain procedures related to the distribution of surplus is limited or mandated by regulatory authorities, and that compliance with such regulations must of necessity take precedence over other considerations.

Section 2. The Contribution Principle

2.1 The basic principle of dividend determination is to distribute the aggregate divisible surplus among policies in the same proportion as the policies are considered to have contributed to divisible surplus. This is said to be the Contribution Principle. In a broad sense, the Contribution Principle provides the essential equity implied by participating business.

2.2 RECOMMENDATION 2: The use of the Contribution Principle in determing dividends is generally accepted practice. The actuary's report should include a statement that this principle has been followed. If it has not been followed, the report should explicitly state any deviations and their rationale.

Section 3. The Process of Dividend Determination

3.1 The application of the Contribution Principle to the determination of dividends requires two basic types of elements: policy factors and experience factors. Policy factors are those elements which reflect the assumptions inherent in the standard against which experience is measured. In contrast, experience factors are those elements which reflect actual experience. Both of these types of factors are discussed in more detail in subsequent Sections of these Recommendations.

3.2 The process of dividend determination leads to a formulation which is used to calculate specific dividends. This process always requires the use of policy and experience factors. However, those factors may or may not appear in the formulation actually used in calculate the dividends.

3.3 Methods of dividend determination described in actuarial literature include:

(a) The Source of Earnings Methods (Or "Contribution Method")
(b) The Asset Share Method
(c) The Fund Method
(d) The Experience Premium Method
(e) The Percentage of Premium Method
(f) The Reversionary Bonus Method

Other methods, including combinations and modifications of the methods above, are also described in the literature. Some methods, such as the Percentage of Premium Method, refer primarily to the formulation used to calculate dividends. Other methods, such as the Asset Share Method, refer primarily to the process used (as opposed to the wide variety of mathematical formulations which may be employed under that method).

3.4 RECOMMENDATION 3: The actuary's report should include a description of the process used to determine dividends as well as the manner in which the policy and experience factors are reflected in that process. The report should also describe the formulations used to calculate dividends.

3.5 Dividend determination is a process subject to practical constraints. The application of these recommendations may reasonably be limited by the cost of calculation, the size of a particular group of policies, the cost and practical difficulty of making a dividend scale change and other similar conditions and circumstances.

3.6 RECOMMENDATION 4: When it would be impractical to apply these recommendations directly to all policies and benefits, the actuary may continue a dividend scale or use approximations or simpler processes and formulations. When such actions are taken, their rationale and impact should be disclosed in the actuary's report.

Section 4. Policy Factors

4.1 Policy factors are those elements which reflect the assumptions inherent in the standard against which experience is measured. Policy factors are elements which are based on the guarantees or underlying actuarial structure of the policy. Examples of policy factors are: cash values, reserves and their associated net premiums, gross premiums, policy loan interest rate, and the rates of interest and mortality used in calculating cash values and reserves.

4.2 In calculating dividends for a particular policy, the policy factors may be the actual factors of that policy or they may be reasonable approximations to the actual factors when practical considerations indicate the need for such approximations.

For example, the actual gross premium per unit of coverage may vary with mode of premium payment, size of policy, sex of insured, rating classification or other items. Often dividends are calculated using a gross premium which may be the annual mode premium for a particular size of policy of an insured of a particular sex who is classified as a standard risk. The differences between such a gross premium and the actual gross premium are intended to provide for the variations in cost associated with the items generating such differences.

4.3 RECOMMENDATION 5: The use of actual or approximate policy factors is generally accepted practice. However, the actuary should include in the report a description of the policy factors and of any changes in practice with respect to their determination for the period covered by the report.

Section 5. Experience Factors

5.1 Experience factors are those elements which reflect actual experience. A particular experience factor reflects actual experience of a specific type. Examples of experience factors are: investment income rates, mortality rates, termination rates, and expense rates. The experience factor for a given type of experience may have several different numerical values. For example, the example, the experience factor corresponding to investment income may have one numerical value for policies with a six percent loan rate, and a different numerical value for policies with an eight percent loan rate. Policies may be combined into groups whose dividends are determined by using a common numerical value of a particular experience factor. Such a group will be referred to as an experience factor class with respect to that factor.

5.2 As used in this opinion, actual experience of a factor class means such experience and trends in experience to the extent that they are determinable, available, and statistically credible. When such suitable data are lacking, actual experience is to be interpreted with sound professional judgment based on experience and trends in experience of other similar classes of business either in the same company or other companies or from other sources, generally in that order of preference.

5.3 If any projection of experience trends is made in determining the experience factor value of any factor class, then such trend projections to the same point in time should be made uniformly for all classes. Such projections should be limited to a relatively short time frame (for example, to reflect the average experience expected during a period for which a dividend scale is likely to remain appropriate), and in particular, they should be used in a consistent manner for both current dividends for policies in force and for illustrated future dividends.

5.4 RECOMMENDATION 6: The actuary's report should describe the experience factor values used. If projection has been used, the type and extent of usage should be stated.

5.5 RECOMMENDATION 7: When there is more than one factor class with respect to a particular experience factor, differences in the value of such factor between any two classes should be based on differences in actual experience between those two classes. In the report, the actuary should identify each such difference. The actuary should also be prepared to provide a demonstration necessary to support such differences.

5.6 The placement of a policy within one experience factor class or another should be based on uniformly applied criteria designed to group together policies with similar levels of experience. In regard to claim factor classes, the actual occurrence or nonoccurrence of a claim on a particular policy should not be a criterion for class placement of that policy.

5.7 RECOMMENDATION 8: The actuary's report should include an identification for the period covered by the report of all changes in values of experience factors and of any changes in practice with respect to determination of experience factor classes or placement of policies within them.

Section 6. Claims Factors

6.1 Statistical data demonstrate significant and valid variations in claims rates by age for most coverages subject to these recommendations. Therefore, an organized set of internally consistent experience factors corresponding to all ages will be considered as one factor in defining a claims factor class.

6.2 Claim rates vary to a significant extent depending on the sex of the insured. When this element is directly reflected in the experience factors, then the set of factors by age and sex will be considered as one factor in defining a claims factor class.

6.3 Another element which is significant for some coverages is the time elapsed since policy issue. When this element is directly reflected in the experience factors, then the entire set of factors by sex, age and duration will be considered as one factor in defining a claims factor class.

6.4 RECOMMENDATION 9: When there is more than one claims factor class, distinctions may be made on the basis of: risk selection class, selection process, marketing method, policy provisions, plan of insurance, premium rate, geographic location, size of policy and date of policy issue. If a basis different from any of these is used, such other basis should be stated in the report, along with an explanation of the rationale and effect of such other basis.

Section 7. Investment Income Factors

7.1 The investment income experience factor generally reflects the investment experience of the individual line of business. This may include not only interest earnings reduced by investment expense, but also the effects of capital gains and losses. Furthermore, the effect of taxation may be reflected as a reduction of before tax investment income. Alternatively, such tax may be treated separately and is addressed on a more general basis in Section 9. The investment income experience factor which results from taking account of the items above, as well as those discussed in the balance of this Section, may have several different numerical values. A group of policies with a common numerical value for this factor constitutes an experience factor class with respect to investment income.

7.2 The investment income for a given group of policies may be directly affected by policy loans. The effect depends on the contractual or actual policy loan interest rate, the corresponding rate after policy loan related expenses, and the utilization rate of loanable funds. The utilization rate may depend on the contractual loan interest rate, the plan of insurance and the size of policy.

7.3 RECOMMENDATION 10: It is generally accepted practice to reflect the effect of policy loans in the investment income factors.

7.4 The investment income, excluding the effect of policy loans, for a given group of policies is directly affected by:

(a) the amount and timing of investable cash flow generated by the insurance operations of the group of policies

(b) the investment income rates initially and subsequently applicable to that cash flow due to investments actually made

(c) the rate of rollover of those investments, which affects investable cash flow in subsequent periods

The portfolio average approach for determining rates of investment income averages the effect of these items over all groups of policies. The investment generation approach recognizes the effect of these items separately on various groups of policies. Various mixed approaches are possible. For example, a company may use an investment generation approach to allocate investment income to the various annual statement lines of business, but use a portfolio average approach to allocate investment income within one or more such line of business.

7.5 RECOMMENDATION 11: The use of either the portfolio average approach or the investment generation approach is considered generally acceptable practice. The detailed procedures for implementing either approach should have a sound theoretical basis. The actuary's report should state which approach is used for allocating investment income to the policies covered by the report. Furthermore, if the approach for a given group of policies has been changed, or if a previously unused approach is to be introduced for a new group of policies, the actuary's report should state that fact and should include a full description of the nature, rationale and effect of such new or revised approach.

Section 8. Termination Factors

8.1 The termination factors represent annual rates of termination of insurance for reasons other than claim.

8.2 Termination factors display significant variation by the time elapsed since policy issue. Other elements which have a significant impact on termination factors include age at issue, sex, frequency of premium payment, plan of insurance and size of the policy. An organized set of internally consistent experience factors corresponding to the preceding elements will be considered as one factor in defining a termination rate factor class.

Section 9. Expense Factors

9.1 Expenses incurred on behalf of a group of policies may in fact depend on most or all of the various elements present in the policies and on the risks insured. Such elements include, but are not limited to, the items listed elsewhere in these Recommendations which affect claims and interest factors. Some expenses are direct in that they can be specifically related to a particular policy. For example, a portion of marketing compensation is usually a direct expense as are certain costs relating to risk selection and policy issue and maintenance. Other expenses are indirect, such as general overhead costs.

Marketing, underwriting, and other costs connected with acquisition of policies may be allocated to all policies or may be recognized specifically as non-level costs to be charged to a policy and amortized. Select mortality savings may be used as an offset to these costs. To the extent that these costs are specifically recognized and amortized, the period and the pattern of amortization will depend on assumptions as to rates of interest and termination.

9.2 RECOMMENDATION 12: In the determination of unit expense rates for dividend purposes, direct costs should be charged to the groups of policies generating those costs and indirect costs should be allocated using sound principles of expense allocation. To the extent that non-level costs are amortized, the amortization should be based on realistic interest and termination rates appropriate for the groups of policies to which they are applied.

9.3 An expense factor class is defined as a group of policies which share a consistent and uniformly applied approach for assessing expenses among policies within that group. More specifically, such a group of policies share a common set of unit expense rates. Those unit rates may be a combination of amounts which, for example, are applied per policy, termination and claim; per unit of risk, coverage, premium, loading, reserves, cash value and expected claims; and per year of premium paying period and coverage period. Further, any of these unit rates may vary by issue age or policy duration and may be modified for tax status, risk class, policy size or other elements. In addition, when there is amortization of non-level costs, a common approach is necessary for that amortization, as well as a common interest rate and set of appropriate termination rates.

9.4 There is considerable latitude in the possible approaches for allocating indirect costs within various groups of policies. Amortization periods and patterns may also vary widely. Different approaches may have been taken at the inception of various historical blocks of business. These variations make reconciliation of different expense factor classes a complex process. One approach to reconciliation is to consider the total expenses charged to one class in relation to another. Total expenses charged to a class are those based on the unit expense rates for that class with due regard for the amortization of non-level expenses.

9.5 RECOMMENDATION 13: A minimum test of consistency between two expense factor classes is that any difference in the total expense charged to each class should be justifiable and in accordance with sound principles of expense analysis. The actuary should include a statement to this effect in the report.

Section 10. Tax and Other Factors

10.1 Details of taxation may vary widely depending on the application of law and regulation in various jurisdictions. However, differences in dividends resulting from differences in taxation should reflect the elements addressed in the tax law.

For example, many companies are taxed on their United States business on a basis which implies that the income tax of each policy depends on:

(a) its rate of allocated investment income

(b) its valuation interest rate and method

(c) its tax-qualified or non tax-qualified status

Therefore, tax factors which appropriately reflect these elements may be incorporated in the determination of dividends. In particular, the tax factors should reflect and be consistent with the rate of allocated investment income.

10.2 RECOMMENDATION 14: Variations in tax factors used in determining dividends should reflect corresponding variations inherent in the applicable laws and regulations imposing that tax and should be consistent with other experience factors.

10.3 Adjustments to dividends are frequently made for a variety of special reasons such as:

(a) to reflect unusual gains or losses on certain supplementary benefit riders

(b) to reflect losses arising from the presence of settlement option guarantees

(c) to smooth the transition from one dividend scale to another

(d) to provide consistency in quantity discounts made to varying degrees in the gross premium structure

(e) to serve as a balancing item so that aggregate dividends equal aggregate divisible surplus

(f) to distribute gains from extraneous sources such as non-par benefits or lines of business

(g) to smooth the incidence of dividends within a dividend scale by policy duration

10.4 RECOMMENDATION 15: The actuary's report should specifically state any special adjustments which are made to dividends, and the actuary should be prepared to provide demonstrations which support the existence and magnitude of such adjustments.

Section 11. Termination Dividends

11.1 The preceding sections have primarily been directed toward the determination of annual dividends. A number of companies also provide for termination dividends payable upon events such as death, maturity and surrender. Such a termination dividend represents the release of an equitable share of surplus and other contingency funds accrued to cover the risks associated with that policy and all others inforce at the time of termination of the policy.

11.2 RECOMMENDATION 16: Termination dividends represent in effect the release of amounts previously accumulated on behalf of the policies on which such dividends are payable. The actuary's report should specifically state whether termination dividends equitably reflect the incidence, size and growth of the policy's share of such amounts and whether differences in termination dividends among different policies reflect differences in the corresponding amounts accumulated. The actuary's report should also include a description of the process used to determine termination dividends and describe any changes in practice with respect to the determination of termination dividends since the last report.

Section 12. Illustrated Dividends

12.1 The methods and procedures stated in these recommendations are intended to apply equally to currently payable dividends for policies in force and to illustrated future dividends for both inforce policies and new policies. When a factor value different from any value of the same factor applicable to older policies is applied to any new policies, special care and attention is required to ensure that the differences in experience factors are based upon sound data, reasonable expectations and equitable methods.

12.2 The actuary may find it desirable to assume a conservative posture in determining an experience factor value applicable only to new or recent issues, if such value differs from values used for any existing policies. In such a case, it is important to bear in mind the degree of uncertainty that exists when factor variations are based upon limited experience data.

12.3 Circumstances can arise under which there is a substantial probability that an illustrated dividend scale which is consistent with current experience cannot be maintained in the near future because of the expected deterioration of experience. In such a situation, the actuary may find it desirable to have as the illustrated dividend scale a reduced scale which is consistent with the expected experience.

12.4 RECOMMENDATION 17: The actuary should conduct tests of illustrated dividends which are adequate to determine whether those illustrated dividends could be paid, if current experience continues. For this purpose, current experience is that which underlies the current scale of dividends payable.

12.5 RECOMMENDATION 18: If there is a substantial probability that the illustrated dividend scale cannot be maintained in the near future because of the expected deterioration of experience, the actuary's report should include a statement to that effect.

12.6 Recommendation 11 states that both the portfolio average approach and the investment generation approach are considered to be generally acceptable practice. However, the difference in effect of these two approaches on illustrated dividends may be considerable. This difference is essentially due to the difference in time periods over which an investment generation is determined.

For the portfolio method, the time period is the age of the oldest outstanding investment. For the investment generation method, the time period may be one year but may also be longer or shorter. For long periods, the two approaches become more and more similar regardless of the past pattern of new investment yields available; for short periods, they may become more dissimilar depending on that past pattern.

12.7 RECOMMENDATION 19: The actuary's report should identify the time period used to determine the portfolio or investment generation rate of return for policies to which the illustrated dividends apply.

12.8 RECOMMENDATION 20: The actuary's primary professional responsibility with regard to illustrated dividends is to ensure that the dividends appropriately reflect the current financial results of the company and are related to paid dividends in an equitable, justifiable manner. This responsibility must be adequately discharged, despite the actuary's recognition of the important role that illustrated dividends play in product cost comparisons and competition in the marketplace.

John H. Harding, chairman, David M. Chernow, Jon C. Christopherson, James W. Kemble, William K. Krisher, Walter N. Miller, Paul J. Overberg, Owen A. Reed, John K. Roberts, Richard M. Stenson, Thomas C. Sutton, and Claude Thau.