

Cash Values

In considering the 1958 CSO revisions, to what extent is it necessary to take into account statutory requirements that cash values be not less than the reserve minus \$25 per thousand?

MR. GEORGE H. DAVIS: There were several states which had not adopted the standard law when the use of the 1941 CSO Mortality Table became mandatory for minimum nonforfeiture values in most states at the beginning of 1948. In some of these states there were either no minimum nonforfeiture requirements or the existing requirements were such as to permit use of nonforfeiture values which complied with the standard law. In others the existing requirements had been amended by the adoption of so-called "short form" bills which modified the existing requirements sufficiently to permit use of nonforfeiture values which complied with the standard law.

The standard nonforfeiture law is now in effect in all but nine states. Five of these nine states have no minimum nonforfeiture requirements. In the remaining four states—North Dakota, South Dakota, Texas, Wyoming—consideration must be given to requirements of nonforfeiture laws which are different from the standard law.

Each of the four states requires cash values after premiums have been paid for three years and such values must be at least equal to the applicable reserves on any standard permitted by the appropriate valuation statute less not more than \$25 per thousand. The minimum valuation standard in North Dakota and South Dakota is either American Experience $4\frac{1}{2}\%$ or Actuaries' Combined Experience $4\frac{1}{2}\%$ and the Commissioners Reserve Valuation Method. Wyoming's minimum standard is either American Experience, 1941 or 1958 CSO, $3\frac{1}{2}\%$ and the Commissioners Reserve Valuation Method. The minimum standard in Texas is American Experience, American Men, 1941 CSO or 1958 CSO $3\frac{1}{2}\%$, and the full preliminary term method. The reserve basis is required to be stated in the policy in Texas and the valuation statute requires the reserve to be calculated on the stated basis. However, this is interpreted, as are other valuation laws, to set only a minimum standard.

When these "short form" bills were originally passed before 1948 they were intended to remove any provisions which conflicted with the use of any provision in the standard nonforfeiture law. It is my understanding that this meant that the minimum values prescribed were never greater than the minimum values prescribed by the standard law, although I have been unable to find any clear statement that this is correct. However, if this was true with respect to the 1941 CSO Table it is not necessarily

true with respect to the 1958 CSO Table because some minimum nonforfeiture values on the new table are less than those on the old.

It seems reasonably certain that any scales of nonforfeiture values would be in compliance with the laws of these four states if they were based on a rate of interest lower than $3\frac{1}{2}\%$ or if they were based on $3\frac{1}{4}\%$ interest but were calculated with adjusted premiums somewhat smaller than the maximum adjusted premiums permitted by the standard law. In any event, it seems that the laws of North Dakota and South Dakota with their relatively low minimum valuation standards would cause no difficulty. If a company's nonforfeiture values are the minimum values permitted by the standard law it seems clear that they would be in compliance with the laws of Texas and Wyoming for the great majority of plans, ages and durations, but some tests may be necessary, particularly at early durations, to determine whether they are everywhere in compliance.

MR. JOHN C. ANTLIFF: The Texas nonforfeiture law exempts all term insurance, South Dakota and Wyoming exempt term insurance of 20 years or less, and North Dakota exempts term policies of 20 years or less.

Term policies of more than 20 years would also be required to provide values under the standard minimum nonforfeiture law. Therefore, the primary effect of the special limitations in these states is on decreasing term insurance of more than 20 years. If a long decreasing term rider is added to the permanent plan which comes closest to the maximum \$25 excess of reserve over cash value, at the crucial durations in the middle of the term where term reserves are highest, any margin between the \$25 limit and the excess of permanent plan reserve over cash value can be recognized in establishing the maximum rider permitted in relation to the amount of the basic policy. A company which offers decreasing term policies of longer than 20 years may wish to decline to offer such policies in these states, at ages where values would be required. It appears that 25 year decreasing term policies or riders expiring as late as age 70 do not produce reserves as high as \$25 per \$1,000 of current death benefit on the 1958 CSO table.

For permanent plans, the \$25 limit should generate higher cash values than the minimums required under the standard nonforfeiture law, assuming 1958 CSO net level premium reserves, at duration 3 or later, for many plans issued at ages in the 30's and for virtually all plans issued at ages over 40. A cash value formula which must be described in a policy as the greater of "formula A" or "formula B," where "formula B" is the reserve minus \$25, is rather clumsy, although not an uncommon concept.

A company using the Commissioners Reserve Valuation Method, under the nonforfeiture laws of these four states, may provide lower cash values than those required under the net level premium method. It seems inappropriate to tie minimum *nonforfeiture* values to an optional reserve basis, since the practical effect of such legal minimums in these four states may well be that a company will decide to provide them in all states in which it operates.