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COST COMPARISONS AND POLICY LANGUAGE

Moderator: C. NORMAN PEACOR. Panelists: DONALD B. MEIER, PAUL J. OVERBERG.

The NAIC Model Life Insurance Solicitation Regulation has recently been accepted.

1. What difficulties are foreseen in complying with it? For example, with regard to timing (earliest effective date) and duplication (5% vs. 4% interest in index calculations).

2. What will be the impact on the sales presentation and process?

3. Will the Buyer's Guide assist the buyer in his awareness and appreciation of the life insurance product?

4. What supplemental material is contemplated for the Buyer's Guide? Do companies intend to draft their own Buyer's Guides and seek approval of them?

5. Should there be required disclosure as to whether dividend illustrations are on a "portfolio" or "new money" interest basis. If so, how and by whom should such disclosure be made?

There has recently been an upsurge of interest in simplified language for life insurance policies.

1. What is the extent of industry and regulatory activities? How successful are these?

2. What legal and administrative problems are anticipated?

3. To what extent will any real progress be made until after the occurrence of court interpretations?

4. Is there a place for an explanatory booklet--in very simple, but non-contractual, wording--even with policies written in simplified wording?

MR. C. NORMAN PEACOR: Representing the con part of this debate will be Mr. Paul Overburg, senior vice president and chief actuary Allstate, not to be confused with State Farm, he tells me. I'll give him the chance to be the first speaker, and he can start in and enlighten us on the NAIC model regulation and what's going on in the cost comparison world.

MR. PAUL J. OVERBERG: My comments this afternoon will be limited to the NAIC Model Life Insurance Solicitation Regulation. My perspective is that of a stock company, one that does not issue participating personal life insurance.

I will cover two main points. The first is to put in a good word for the NAIC Model Life Insurance Solicitation Regulation and to urge you and your companies to support it. My second point is to offer a different, but not new, perspective to the "portfolio" vs. "new money" debate.

Some of you in the audience may still feel that this NAIC model regulation is unnecessary, that it will not be useful to the consumer, and that it is the result of over-reaction to a few vocal self-appointed consumer advocates who reflect the thinking of a very small minority of consumers. To those of you who share this belief, I suggest that you consider what some of the alternatives might be, and there will be alternatives. I'd like to review the history of how the Stone Bill originated. I will mention a few of the highlights:

1. Tens of thousands of G.I.'s were being discharged from the Vietnam conflict.

2. Each was told he had 120 days to convert his G.I. insurance to a Whole Life policy in any one of over 100 different life insurance companies.

3. Many Vets checked with two or more companies and discovered the premiums often varied by 25% or more.

4. The VA was asked for help. How can you compare the cost of two or more life insurance policies?

5. The VA soon found out that:

    a. The traditional method of net cost comparison was misleading, and

    b. There was no universally accepted or official method of comparing the cost of life insurance policies.

The VA's problem is not unique. Many others have pointed out this need for a standardized method of comparing life insurance costs. The NAIC model can fill this need, but only if it becomes "universally accepted".

For added evidence of the need for an official method of cost comparison, I suggest you review the Hart Bill and the numerous Shopper's Guides with their distorted and misleading cost comparisons that have been published in the last four years. Then, lest you forget, there are already nine states that have some regulation currently in effect pertaining to the solicitation of personal life insurance. Each of these regulations differs to some degree from the new NAIC model regulation.

Iowa has adopted the new model regulation effective July 1, 1977 and New Jersey is expected to adopt the new NAIC model in two stages. Commencing January 1, 1977, the Buyer's Guide will be required and commencing January 1, 1978, the Policy Summary will be required. A number of other states can be expected to adopt some form of disclosure regulation within the next two years.

It is obvious that uniformity is needed. It is needed to make the information more meaningful to the public and agents, and to keep down the cost of supplying the information. In the long run, the customer is going to end up paying this added cost.

The NAIC model regulation is not perfect. It is a compromise that has evolved over the last four years. Given the present environment where some regulation already exists and more is quite likely, I feel that the NAIC model is the best compromise and should be supported. Whenever any state considers life insurance cost disclosure or solicitation regulation, I urge you to encourage the state to adopt regulations that are consistent with the NAIC model.

While I am sure that each of you can point out what you believe to be shortcomings of the model regulation, the final regulation is such that the stock companies, mutual companies, and the agents should be able to live with it. At the same time, the model regulation does what it is supposed to do. It establishes an official method of comparing costs and it provides information that can be used to help in the purchasing process by those consumers who so choose to use it. No one will deny that the regulation will increase the cost of the selling process of personal life insurance.

The model regulation requires among other things that a Policy Summary and a Buyer's Guide must be given to every prospective customer prior to accepting any premium deposits. If the company gives a ten day free look, you can delay the delivery of these two items until the day the policy is given to the potential customer. The Buyer's Guide should not present any problems so long as it is uniform for all states. It is a simple, easy to read, preprinted booklet. It is not expected to have an immediate effect on the general public's awareness and appreciation for life insurance. However, if most of the states require its use, over ten million of the Buyer's Guides would be distributed each year. Such wide distribution should have at least some gradual effect on the general public.

The Policy Summary will be of much more concern both to the agents and to the companies. The Policy Summary requires cost indexes, equivalent level annual dividend indexes, as well as detailed information on the premium, the amount of insurance on each person insured under the policy, the cash values, and the illustrated dividends. This detailed information must be supplied with the basic policy and each optional rider for about 8 different policy durations and must be given for the total amount of insurance. It cannot be on a per $1,000 basis.

If the company gives the ten day free look, then the Policy Summary can be completed in the Home Office and perhaps as a by-product of the computer at the same time the policy is issued. But for many companies, especially the smaller ones, preparing these summaries in the Home Office will not be a welcomed task. Without the ten day free look provision the company must give the agent a supply of Buyer's Guides and the ratebook must also contain information needed to complete the Policy Summary. This will indeed be time consuming for the agent to compute in front of the prospect. The time required to do the arithmetic could distract from the real purpose of the sales interview, which is to convince the prospect that he needs insurance and that now is the time to fill this need. Since supplying this information can interfere with the sales process, it would appear much better to give the customer a ten day free look and supply the required information at time of delivery. Pennsylvania is currently the only state that requires information to be given to all prospects prior to accepting a downpayment.

For the sake of emphasis, during the next few minutes I am going to play the role of the devil's advocate and, as such, let's re-examine what dividend illustrations are and what they are not. They are not guaranteed, and under the NAIC model regulation they must be based on the company's current scale. Thus, they are not estimates or projections of what will be paid. The method of calculating dividend illustrations is already regulated by the state of New York and by several other states. Under these existing regulations, actuaries can have differing opinions:

1. As to whether equity has been maintained between policies issued under the company's current ratebook and prior ratebooks.

2. Opinions differ as to whether it is appropriate for a small growing company to anticipate expense savings due to expected lower unit cost and to reflect these savings in their current scale, but not apply them to their older in force policies.

3. Opinions differ as to whether it is appropriate for a company to increase its gross premiums and introduce a steeper dividend scale even though its current gross premiums are already relatively high.

4. Opinions differ as to whether it is appropriate to introduce and illustrate a twentieth year terminal dividend for its current scale but not make it applicable to prior issues.

5. Opinions differ as to how much should be declared payable each year and how such amount should be allocated to the various classes of business.

6. Opinions differ as to whether it is appropriate to use a new money rate for current issues.

These items point out that even with the requirement that illustrated dividends must be based on the company's current scale, the degree of optimism in the scale can vary significantly from company to company. This variance in illustrated dividends, plus the relative variance in the amount of dividends actually paid, makes it difficult to determine in advance which of two participating policies will prove to be the better buy. This is especially true when looking at the 20th year death and surrender cost indexes.

The ALIA brought this point out very vividly in a study they did in 1974 for the NAIC research project number six. Their study measured the correlation or rankings of cost indexes of participating policies, first based on dividends illustrated at the time of issue and the comparable rankings based on the actual dividends paid. The correlation was quite high (between .92 and .98) for the 10th year surrender cost indexes. However, the correlation was much lower (between .73 and .82) for the 20th year surrender cost indexes. One of their studies covered the Whole Life policies issued in 1953 by 19 large mutual companies. Their results for issue age 35 are contained in Table I. This table clearly demonstrates that illustrated dividends are often not indicative of which of two or three participating policies will prove to have the lower or lowest cost. The same problem would exist whether we use the interest adjusted method or any other method of cost comparison which gives equal weight to non-guaranteed and guaranteed values. This does not mean that the interest adjusted cost indexes based on illustrated dividends should not be used as a means to helping the consumer to decide which of two participating policies may prove to be the better buy. In fact, I believe the table clearly indicates that more often than not it will be a correct indicator of which of the two policies will be the better buy. The important point is not to let the consumer fall into the trap of believing that dividend illustrations are sacred and are always a true indicator of relative cost. Our agents tell me that when they are in competition with a participating policy, their prospects often assume that the illustrated dividends are just as real as guaranteed cash values.

Part of this public misconception that illustrated dividends are sacred may very well come from the numberous Shopper's Guides that have been published, especially over the last five years. These Shopper's Guides invariably fail to indicate the non-guaranteed nature of illustrated dividends on the pages where the cost indexes appear. The editors of these Shopper's Guides do not have to comply with insurance laws and regulations. They might put the caveat on each page of their Shopper's Guides if more actuaries would express their opinions to them on the use of such caveats.

Gentlemen and ladies, we face a serious problem. The industry must find some way to reduce the apparent unseen pressure for companies to publish ever increasingly optimistic illustrated dividends. This may result in showing lower cost indexes, but in the long run, not lower cost. If we do not find the solution, we can expect to have an ever increasing amount of regulation on the method of calculating illustrated dividends. This in turn could lead to rate regulation, and rate regulation could bring on the demand for standardized policy forms with standardized benefits. Standardized policy forms with rate regulations will in my opinion be detrimental to the vast majority of consumers. Because of the long term nature of the life insurance contract, the regulators will have to set the rates at a level which will not impair the solvency of the companies. Thus many consumers may end up paying more for their insurance than they currently are.

The Society of Actuaries has a special committee on Dividend Philosophy chaired by Ed Matz of John Hancock. Hopefully this Committee can find an answer to this dilemma. One suggestion to control the degree of optimism in illustrated dividends is to use each company's past history on dividends paid and illustrated as an index to the reliability of its current illustrated dividends. This suggestion has been made a number of times, but it fails to recognize that the degree of conservatism (or lack thereof) will vary within a company as management changes.

I have one final statement to close the role of the devil's advocate. Let's remember that the more we in the industry imply that illustrated dividends are sacred and, by our inaction, let the consumers assume that dividend illustrations are an infallible index to relative cost rankings, the more optimistic the illustrated dividend scale will become. The use of the new money concept is but one of the many ways you, as actuaries, will be forced to innovate over the next decade to help you and your company take your rightful place in this race to see who can develop the most optimistic scale of illustrated dividends.

Let's concentrate on the industry's primary obligation to the American public. That is to point out their life insurance needs and then fill those needs. Let's not get boggled down in the murky sea of optimistic dividend scales when no one on this earth can determine in advance which of two par policies will prove to be the better buy. Let's emphasize our service and our reputations. Let's all make sure our respective customers are in our respective company's good hands.

Table I
20th Year Surrender Cost Indexes

Illustrated vs. Actual Dividends
Policies Issued in 1953 by
19 Large Mutual Life Insurance Companies*
Issue Age 35

Policy Issued by Company	20th Year Surrender Cost Index at 4%: Based on Illustrated Dividends — Index	Rank	Based on Actual Dividends — Index	Rank
A	6.94	1	5.53	2
B	7.56	2	5.86	6
C	7.71	3	6.25	8
D	7.97	4	5.65	4
E	7.99	5	5.84	5
F	8.28	6	5.31	1
G	8.36	7	6.97	11
H	8.40	8	6.10	7
J	8.42	9	7.44	15
K	8.61	10	6.33	9
L	8.64	11	7.18	13
M	8.68	12	6.48	10
N	8.86	13	7.04	12
P	8.93	14	7.43	14
Q	8.99	15	5.62	3
R	9.60	16	8.90	17
S	9.81	17	10.52	19
T	10.27	18	8.90	17
U	10.39	19	8.19	16

*Data reproduced from Table B of ALIA report to NAIC on Research Project Number 6.

MR. DONALD B. MAIER: "We support the principles and purpose of the NAIC Model Life Insurance Solicitation Regulation". I was wondering how many times essentially these words have been used over the last several years to preface some suggestion or other to amend the then current model so that it would be easier or less expensive for a particular company to comply or to try to gain a greater advantage, or at least less disadvantage, for a particular class of business or for a particular type of policy.

Now the hearings are over and the NAIC has officially accepted the Model Regulation. It is timely that we review what we've got and consider how the industry will adapt to it. Will its overall effect be good or bad on balance?

Paul Overberg has discussed the program questions primarily from the stock company point of view for nonparticipating business. I'm to discuss these questions from the point of view of a mutual company and participating business. The basic difference, of course, is dividends. From the administrative point of view, providing the detailed dividend information required by the regulation can present a major burden. Dividend scales change from time to time, generally much more frequently than basic premiums and cash values. A change in dividend scales means that many of the numbers that go into the disclosure material must be changed. Dividends also complicate matters from the salesman's point of view. He is now faced with the task of explaining dividends in a context which may be completely new, in addition to having to be prepared for intelligent discussion of the other factors brought out in the Buyer's Guide and Policy Summary. And the actuary, in a mutual company, has a potentially even more serious challenge, which I'll discuss in some more detail later.

Turning now to the specific questions:

1. What difficulties are foreseen in complying with the NAIC Model?

   The answer here will depend on the configuration of each company's electronic system and the make-up of the policy portfolio - the number of bands of policies with different dividend scales, etc. I see four major potential problem areas:

   a. The Model requires various numerical amounts -- cash values, death benefits, dividends -- to be presented on a "per policy" basis, not on a per thousand or per unit basis.

      Let's take just one of these - cash values. Many companies have continued the common practice of providing cash values in policy forms by means of preprinted tables with values on a per thousand basis. To provide these numbers on a per policy basis will require a major new reprogramming for such companies.

      Similarly, in the case of Family Income, many companies issue Family Income Riders in any amount of monthly income providing it is within the company's underwriting limits. These riders will show commuted values at various durations, but only on the basis of each $10 of monthly income. The regulation requires that these figures be converted to an actual policy amount basis for the durations specified.

   b. Where the Equivalent Level Death Benefit is less than $5,000, certain data, primarily the year-by-year display of cash values and dividends, may be omitted from the Policy Summary. This will undoubtedly be a help to those companies issuing a large number of policies that fit this exclusion. Other companies may have a band of smaller policies which don't quite fit the exclusion but which are marketed on a pre-packaged basis in order to streamline administration and minimize cost. However, the regulation will require all of the same data for these policies as for the larger policies. Up to now, there has been little demand for detailed cash value and, especially, dividend information on this band of smaller policies. Hence, the data may not be readily available in the existing electronic system. This can mean, and does mean for Metropolitan, a huge reprogramming job. I don't think the word "reprogramming" does justice to what's entailed. Our electronic experts would describe it as a major restructuring of the system or something like that.

c. The kinds of data required by the Policy Summary are generally readily available in the unit that routinely turns out dividend illustrations for sales presentations. Except for the special concern I just mentioned with regard to a band of small amount policies, assembling the specified data in the form required may not be a terribly serious problem for such a unit. The catch, though, is to get the output from this unit matched up exactly with a policy being issued in another unit and by another electronics system. This matching, physically getting a printout from one system together with a policy from another system, is loaded with potential problems. The ultimate solution would be to have the Policy Summary automatically produced together with the policy being issued. This, again, is a system change of major proportions and will require considerable lead time to accomplish.

d. Next, we have the duplication example given in the program. Some states still call for indexes at 4% under a previously enacted regulation. Iowa, New Jersey and Missouri are thus far proposing to enact the Model and will require us to use 5%. Companies may include interest-adjusted figures in rate books and other supplementary material and they may routinely provide interest-adjusted figures with ledger statements. The physical problem of simultaneously turning out interest-adjusted figures at two different interest rates will be expensive and, of course, can easily lead to errors. I can also see a prospective purchaser comparing a 4% index with a 5% index, having no idea of how to interpret the difference.

This brings me to another major concern in the area of compliance--the likelihood of state by state variations. Say, we're at the point in 1977 when we've completed the enormous task of revamping systems so that we can comply with the Model relatively efficiently. My concern is that, based on recent experience, we're almost sure to get substantial variations from state to state. Just look at the history of the prior "interim" regulation, which was substantially adopted in 6 or 7 states. No two were exactly alike. Each state put in its own wrinkle. Perhaps each new state wanted to do a little better job than its predecessors. Of course, the extent to which states vary from the Model remains to be seen, but I think that it is potentially the most serious compliance problem we can have.

2. What will be the impact on the sales presentation and process?

If you take literally the statements made by the various salesmen at the hearings, one might expect it to be terribly disruptive. My own guess is that the overall impact will be slight, but that it will be very significant in occasional instances.

I'd like to compare this with my reaction to certain literature I received with my new car. A card told me in what distance I could stop when I was travelling at various speeds, with or without the benefit of power brakes. The reverse side told me how long in seconds and how far in feet it would take to pass a vehicle beginning at various speeds. I really didn't have the patience or the time to figure out what use I could make of these data. The case was similar for the great bulk of the material in my owner's manual. I glanced through it, decided I was too busy and would read it later. I put it in the glove compartment and it's been there ever since. I think this is equivalent to what will happen to the life insurance disclosure material, for the most part.

I believe that the prevalent feeling of the marketing people is also that this material will have only slight effect on the sales process and our experience to date in those states which have adopted the interim regulation seems to bear this out. The closest parallel at present is the Pennsylvania disclosure requirement, which utilizes a "Policy Summary", although much shorter and simpler than the NAIC Model's version. Surveys of our field force in Pennsylvania to date have not indicated any serious problem with the use of the Policy Summary. (Note, however, that the Pennsylvania Association of Life Underwriters is currently suing the Insurance Commissioner, alleging serious impairment of their ability to carry out their professional activities.)

One provision of the Model that may well be felt to be disruptive for a mutual company is the requirement that any sales presentation which is based on illustrative data, including dividends, must also show, with equal prominence, the corresponding guaranteed amount. Sales presentations for life insurance and annuity products often emphasize the total illustrative cash value (including dividends) available at, say, age 65; and the monthly income available by applying that cash total under a life income settlement option using today's illustrative monthly income rates. The showing of guaranteed amounts as well as illustrated rates, particularly the life income at conservative guaranteed rates, may well cause problems in sales presentations.

3. Will the Buyer's Guide assist the buyer in his awareness and appreciation of the life insurance product?

Once again, my guess is that the impact will be slight. No doubt the Guide will generate some questions and interest on the part of a minority of buyers. It can hardly help but raise the public's understanding and awareness, at least to some extent, and this has got to be considered to be a positive benefit.

Of particular interest in regard to this Question 3 are two questions which were asked in a survey done for certain research projects requested by the NAIC. One was "Is there any particular type of information about life insurance that you would like to have, that you do not now have, or don't know enough about?". This question was answered "Yes" by 20% of the respondents. Of those who answered "Yes", 44% said they would like "general information". The Buyer's Guide should prove ideal for these people.

On the other hand, the NAIC Task Force also did some market research, using the wording of the actual Buyer's Guide as contained in the NAIC Model. The results reported were not too promising. The sections on Cost Comparison and Indexes were generally not very well understood.

One of the major areas that I believe will be brought out by the Buyer's Guide is that there are two kinds of policies, participating and non-participating. An explanation of the difference appears in one of the early paragraphs under the attractive heading "Finding A Low Cost Policy" and I think this will catch the eye of most readers. I don't know whether par or non-par ends up with an advantage here. I just have the feeling that most prospects presently aren't aware that they have a choice.

Another thing that the Buyer's Guide may well do is to increase price awareness. I know that this was the major original thrust for cost disclosure regulation, but I'm not sure that this result is all positive. I'll discuss this a little more, later.

4. What supplemental material is contemplated for the Buyer's Guide? Do companies intend to draft their own Buyer's Guides and seek approval of them?

The regulation requires that the language be limited to that set forth or language approved by appropriate supervisory authority. A particular state or even several states may approve a variation in the language from that specifically set forth in the Buyer's Guide so that you might use such different version in those states. However, I'm fairly certain that, even where exceptions are permitted, the same exceptions will not be acceptable in all of the states. For a nationwide company, this may effectively restrict you to the Model's wording without change. I doubt that it would be administratively feasible to have a series of different versions depending on what wording was accepted in each state.

I believe that it will be common practice to supplement the Buyer's Guide with additional company related material, but we will have to be careful that it be presented to complement the Model wording rather than disguise it. From the regulator's point of view, I'd be concerned that this could be presented in such a way that the Buyer's Guide comes out to appear to be the supplement and of secondary importance.

5. Should there be required disclosure as to whether dividend illustrations are on a "portfolio" or "new money" interest basis? If so, how and by whom should such disclosure be made?

There is no doubt in my mind that the answer to the first part of the question is "yes". The fact that a dividend illustration is on a "new money" basis should be disclosed. Entirely aside from any question of equity as between new and old policyholders, the "new money" basis can result in illustrated figures with an apparent advantage, when compared to portfolio figures, an advantage which, in my opinion, is too optimistic and should bear some sort of qualification.

The Society of Actuaries' Committee on Dividend Philosophy, chaired by Ed Matz, is studying this whole matter of illustrative dividend bases. Ed Lancaster and Norm Peacor are members of that committee. I know that "new money" vs. "portfolio" interest bases is one of their major concerns. I don't believe that they feel that a solution is right around the corner.

This particular question, "new money" vs. "portfolio" basis dividend illustrations, is only one manifestation of many allied problems which may confront the mutual company actuary to a much greater extent over the next several years. Remember, the thrust of the regulation is on cost disclosure. One of its purposes is to make the life insurance buyer more price conscious , to get him to shop around for a better buy. I know that some feel that this will cause the industry to tighten its belt, to cut out waste and excess profits and, thus, reduce the cost of life insurance to the insurance-buying public. The question of the extent to which overall costs would be reduced, if at all, and the possible effect of gradually shifting business to those companies who come up with lower index numbers, can easily form the basis for a Panel Discussion in itself.

What I'd like to mention here is the challenge to actuarial integrity that can be presented by significantly increased emphasis on cost comparison.

I'm not questioning the motives of any company which may have adopted a "new money" system, but isn't there a great temptation to achieve an instantaneous improvement in cost ranking through the adoption of such a system for recently issued business?

Similarly, won't it be easier to find a justification for using significantly lower mortality on recently issued business if it results in a really improved cost position, particularly on term insurance.

Some companies have been accused of establishing cash value patterns which have a unique advantageous effect on interest-adjusted results.

Since "standard" policies are most frequently used as a basis for comparison, it may be desirable to design a standard classification which is, in fact, rather restrictive. This "standard" policy would be the basis offered for comparison, even though not very many persons would actually qualify for it.

I have always felt that the major job of the actuary involved with pricing, the actuary who is responsible for the establishment of dividend scales, is to carry out the mutual company's promise to our existing policyholders that they will receive their insurance at cost. I further believe the promise means we will strive to minimize that cost to the extent that it's feasible and equitable.

In a system which emphasizes, perhaps overemphasizes, competitive cost illustrations, it becomes increasingly easy to justify favoring new business, since this is the basis for cost comparisons. After all, without a good cost position the volume of new issues will not be maintained, the amount of business over which expenses can be spread will go down, morale and efficiency will also be affected. Thus, it begins to seem quite clear that it is in the best interest of existing policyholders to present a good cost position to attract a sufficient volume of new business.

This increased pressure on competitive cost position can present a real challenge to the integrity of the mutual company actuary.

MR. PEACOR: Let me ask you to shift gears and turn to the second part of the program.

At the time the first question on the subject of simplified language was prepared, it seemed to be primarily of academic interest. Now, however, at least for those of us from Massachusetts, the question has taken on a sense of personal immediacy. Because of its import on all companies, let me treat it at some length.

The State of Massachusetts has held hearings on Senate Bill No. 1451. It is a bill that would require insurance policies to be written in easily understood language. An important section provides that a policy form shall not be approved which does not achieve at a minimum a score representing comprehension by an average high school graduate on an appropriate readability test. The test as such is undefined, but it is very likely that that devised by Dr. Rudolph Flesch and described in his book "The Act of Readable Writing" is a prime candidate for use.

A second section of the Bill states that all policy forms presently approved by the Department of Insurance must comply with the requirements of the Bill as of the effective date of the act. The Bill then goes on to set the effective date as of January 1, 1979.

In the words of the question, this is quite an extensive regulatory activity. It would apply to all companies doing business in Massachusetts so that the problem is not merely a local one. It means that every company would have to rewrite and file all of its policy forms and associated documents in a little over two years if the company wishes to continue to do business in Massachusetts.

In some respects, this Bill presents a problem illustrating the weakness of State regulation. It refers to rewriting the policies in Massachusetts for the comprehension of an average high school graduate. By contrast, Texas has a proposed regulation with respect to accident and health insurance policies which would require "a specific minimum level of readability no less than the equivalent of a 9th grade education". If a subsequent Texas regulation, or that of any other state, should come out requiring readability at the 9th grade level, then the Massachusetts level goes by the boards. The problem for the companies is that they must now attempt to rewrite the policies at the assumed minimum level of readability and hope that it stands up as the various states set their own criterion.

The bill has been tabled for 1976,but it is likely that it will pass in 1977. In impact, it is certainly the most stringent to be applied to the life insurance business.

A word concerning the tests. The Texas regulation specifically sets forward seven and, then, has a catchall of allowing the Commissioner to set any other that he may wish. Certainly, the one associated with the name of Dr. Flesch has received the most publicity, and it is, perhaps, appropriate to refer to it. Just for the sake of illustration, I offer the following three examples on the subject of assignability as it would be written in various forms for a life insurance policy:

ASSIGNABILITY

(AS WRITTEN)

This policy may be assigned but the Company will not be charged with notice of any assignment unless it is in writing and until the original or a true copy thereof is received at the Home Office. The Company does not assume responsibility for the validity of any assignment. The interest of any beneficiary and of any other person shall be subject to any written assignment received by the Company. Any assignment shall be subject to any indebtedness under this policy.

(Flesch Readability Score 37.104 - 13th to 16th grade level)

ASSIGNABILITY

(FIRST REVISION)

This policy may be assigned. The Company shall not be charged with notice of any assignment unless it is in writing. A true copy of the assignment must be received at the Home Office. The Company does not guarantee that any assignment is valid. The interest of any beneficiary and of any other person shall be subject to any written assignment. Any assignment shall be subject to any indebtedness under this policy.

(Flesch Readability Score 52.481 - 10th to 12th grade level)

ASSIGNABILITY

(SECOND REVISION)

This policy may be assigned. We can't know of any assignment unless it is in writing and a copy is received by us. We don't guarantee that the assignment is valid. However, the rights of all persons shall be subject to it. The assignment will be subject to any indebtedness under this policy.

(Flesch Readability Score 66.782 - 8th to 9th grade level)

Moving on to take a look at some of the other questions, the legal implications are considerable. Many phrases and sections of the life insurance contract have been derived from court tests or regulatory or legislative fiat. It seems to me that the legal problems will be almost immediately encountered if we get the sweeping rewrite job done in Massachusetts. We will probably be back into the courts again on contract interpretation in areas we once felt were completely resolved in law. On the other hand, an optimistic view would say that the rewording of the contracts at a 10th grade level will make them so clear that there can be no question as to the intent of the contract. It remains to be seen, however, whether this optimistic viewpoint will hold as we start all over in the courts.

Obviously, the administrative problems are going to be considerable and not only for the insurance companies. It boggles my mind in reflecting on the Massachusetts pending Bill to think of the policy form section of the Insurance Commissioner's office as it will look in late 1978. Can you imagine the rooms full of paper completely inundating a staff which must now not only read and interpret the new policies but must also pass on their readability level. It is an interesting picture.

Insofar as a company such as my own is concerned, the task is formidable but certainly not impossible. We are, in fact, gearing up for it, and a task force is now in place to get the job done. It is more than merely coming out with a new policy series since all forms will have to be revised. At the same time, it is less than a new policy series since the price structure, at least for us, is presumed to remain the same. We would, obviously, much rather have the two-tiered approach, but the present Bill does not contemplate such an occurrence. By two-tiered, I mean a process whereby all new policy forms would be submitted with the required level of readability and that the existing policy forms would have a much longer period of time available in which to complete the rewrite job.

Question 4 refers to an explanatory booklet. It seems to me that we already have such a one, and it is certainly written in straightforward language. I am not sure that a readability test has been applied to it, but it must certainly be conceded that it is more readable than the policy itself. I have reference, of course, to the booklet entitled "Plain Talk About Your Life Insurance Policy" as published by the Consumer and Community Services Section of the Institute of Life Insurance. I would take the side of the argument that says that a booklet such as this is appropriate even in those instances where the policies have been written in simplified wording. The use of illustrations and color contributes to its readability, and both of these items are missing from the standard life insurance policy. We do have, of course, the requirement that a descriptive booklet will be given to the policyholder along with the cost comparison index as required or as will be required by the NAIC model regulation. I doubt that that document would pass the Flesch test so it is probably already eligible for rewrite to make it more readable. In any event, this point merely illustrates how extensive may be the rewriting of material that we show or give to our consumer, the policyholder.

MR. ERNEST J. MOORHEAD: May I draw attention to a statistical problem worthy of actuarial attention in this cost comparison area. In this discussion I shall (1) state the problem, (2) describe a procedure that has been used and found wanting, (3) offer a better solution, (4) challenge actuaries to exercise your skill and ingenuity in devising a solution that is superior to mine.

(1) The problem is to measure the usefulness of dividend illustrations in determining whether or not a particular participating policy is sufficiently attractive in price to justify its purchase--or, on the other

hand, whether dividends are so volatile that illustrated dividends turn out to have little positive value for use in policy cost comparisons among participating policies.

In this description the following notation will be used:

n = number of different policies for which comparative cost information is available.

${}_{20}C$ = interest-adjusted cost index calculated over 20 policy years.

C_t = the cost index for the policy that ranks in the t^{th} position among the n policies.

C^i = the cost index illustrated at time of policy issue.

${}_{20}C^a$ = the cost index calculated 20 years later using actual dividends that have been paid.

(2) The system that has been used but has proved unsatisfactory has been to compare the rankings of the n policies determined from illustrated and actual dividends respectively by using established statistical coefficients of rank correlation. The weakness is that this process fails to recognize the extent to which cost indexes are closely clustered or widely separated.

(3) A solution that at least partly overcomes the difficulty is to examine for each of the n policies the value of

$$ {}_{20}C^a_{t+k} - {}_{20}C^a_t $$

where t + k is the rank based on actual dividends occupied by a policy that occupied rank t according to its illustrated dividends.

If the value of this expression is zero or negative, it can reasonably be said that the buyer has not been hurt by having relied on the message conveyed to him by illustrated dividends.

If the value is positive but less than, say, 50 cents, it can in this observer's opinion, be said that the buyer has not been materially hurt by having relied on illustrative dividends. This is because interest-adjusted cost indexes must be recognized as approximations only.

If the value is positive by at least 50 cents, the buyer can be said to have been harmed by having relied on dividend illustrations provided the illustrated result was at least among the half of the n policies of less than median cost. (If the exhibit at time of issue showed that the policy was relatively high in cost, the buyer presumably bought it at his own peril.)

(4) Better suggestions for solving this important mathematical problem ought to be welcomed by all of us who are involved in this cost comparison question.