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EQUITY FOR EXISTING POLICYOWNERS

Moderator: JAMES F. REISKYTL. Panelists: ARNOLD A. DICKE, NORMAN E. HILL, RICHARD CHARLES MURPHY

1. What is equity?

   a. Participating business
   b. Nonparticipating business

2. What are the guidelines for maintaining equity among existing policyowners? Between new and existing policyowners? Are these guidelines being followed?

3. To what extent have changes in the industry and environment affected equity?

   a. New valuation and nonforfeiture laws (lower premiums; tax advantages)
   b. Increased or variable policy loan interest rate provisions (higher dividends)
   c. New products (flexible annuities, universal life, low cost term)
   d. New underwriting classifications (smoker/nonsmoker; preferred risk)
   e. Changes in dividend philosophy (IYM, termination dividends)
   f. Other

4. Does the current high level of replacement activity result from inequity? Cause inequity between classes of policyholders?

   a. Deposit term replacement campaigns
   b. Market value losses
   c. Equity between those who surrender and those who remain
   d. Other

5. What strategies are being adopted for maintaining equity and/or restraining replacements? With what effect on various segments of the inforce?

   a. Dividend changes
   b. Indeterminate premium changes
   c. Unilateral updating
   d. Exchange programs/bilateral amendment
   e. Commission adjustments
   f. Active replacement of others' business
   g. Other

MR. JAMES F. REISKYTL: I would like to begin our discussion with a consideration of the basic principles of equity. Equity is a concept that lends itself to intuitive understanding but is very difficult to define. In fact, the literature is relatively devoid of practical definitions of equity.

Do companies treat policyholders equitably in order to be fair, or do they do so if they can, or only if they have to? In other words, some define equity as something you do <u>if</u>--if you have to or if you can. I'd like to ask Arnold Dicke to begin the discussion.

MR. ARNOLD A. DICKE: I will consider the question of equity for participating policies and Rich Murphy will cover the nonparticipating policies. The dividend mechanism is the primary means of assuring equity for participating policies in a mutual company. Gross premiums are established at a level high enough to cover all but very improbable contingencies, and dividends are employed to release surplus as the need for it diminishes so that insurance is provided "at cost" to the participating policyholder.

Dividends usually are determined through the contribution principle. The Academy's "Recommendations on Dividend Determination" state that "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. . . . In a broad sense, the contribution principle provides the essential equity implied by participating business. "

In practice this requires both:

(1) a <u>classification</u> of policies into blocks or dividend classes that will receive the same unit dividends; and

(2) an <u>allocation procedure</u> that attributes income and disbursements to the appropriate blocks of business.

If equity is to be achieved, the classification system must produce reasonably homogeneous classes and the allocation procedure must be reasonably precise and evenhanded - precise about direct income and expenses and evenhanded in the treatment of items such as overhead expense that cannot be attributed directly to a source.

If these criteria were met for a block of policies at the time of issue, the question of maintaining equity within this block and with other, perhaps newer, blocks of business involves both:

(1) <u>continuity</u> with regard to procedures applied to the block in the past; and

(2) <u>consistency</u> with procedures used currently on other blocks, including new policies.

These two attributes may be in conflict, both with respect to the classification of policies and with respect to the allocation procedures.

For example, a new underwriting classification such as sex or smoking may appear to be important at some point in time even though it previously had not been recognized in the classification structure. If these new classes are to be introduced for new issues, should the same classifications apply to existing business? How important is it not to "change the rules after the game has begun?" Is the answer different for classification factors over which the insured has some control?

One respondent to a survey I took in preparation for this session stated flatly that "no policy should be withdrawn from a dividend class if the result is to worsen the experience (and thus the dividends) for the remaining policies in the class;" a position that clearly precludes all refining of dividend classes after issue. On the other hand, if the new classification is not recognized, it is clear that certain policyholders within each class will be subsidized by others in the same class.

Similarly, new allocation procedures may be considered, such as the investment generation method of allocating investment income. The continuity requirement obliges the company to retain the portfolio-average method to honor the implied agreement under which existing policies were written. However, if the method is to be introduced for new policies, consistency would have the new method extended to all policies. For example, an investment generation method that assigns a calendar year interest rate to the increase in reserve or cash value each year could be applied consistently to old or new policies. With this method, new cash value increments for existing as well as new policies are allocated investment income on the basis of new money rates. In practice, a company may compromise between continuity and consistency. For example, a policy may be assigned to one of several generations, depending on year of issue. Within each generation, a single portfolio-average rate is determined. While this method decreases the inhomogeneity of the original classification, it fails to distinguish between paid-up and premium-paying policies with regard to current contributions to investable funds.

A more exotic type of allocation problem is cropping up these days as even mutual companies are establishing stock subsidiaries, mainly for tax and investment reasons, and using them to market new kinds of products such as universal life. The subsidiaries are structured as an investment, and the policyholders of the subsidiary conceivably could be viewed as customers of a stock life insurance company that happens to be fully owned by a mutual insurance company. From this point of view, the subsidiary policies not only would be a distinct block of business but also would not be involved in the allocation procedure that applied to policyholders of the parent. In fact, the subsidiary policyholders might be thought to fall under a completely distinct equity regime.

The alternative point of view is that the wholly-owned subidiary is only a device to effect certain investment, management, and tax programs needed for the new generation of products. As a result, the parent should view the subsidiary policyholders in the same light as those who purchase coverage directly and should treat the two blocks of policyowners as part of the same company in determining relative equities.

The choice between these approaches obviously will affect the balance between policyholders having (new or existing) traditional contracts and those having new-generation policies. This is a thorny problem that we may wish to discuss further after we have heard about equity as it applies to nonparticipating policies.

MR. RICHARD CHARLES MURPHY: First, I would like to discuss the question of equity with respect to fully guaranteed nonparticipating policies--the old fashioned kind. Then I have a few comments on these equity issues as they apply to adjustable-premium policies.

Webster defines equity as a fairness in dealing between parties. On this basis, we should consider both equity between policyholders and stockholders and equity among policyholders of different generations.

Given the underlying mortality assumptions and expense levels of the late 1940s, it is likely that the rate of return to policyholders on policies issued at that time was 1½ to 2 percent. These same policies provided a projected return of 3 to 5 percent for the stockholders. The stockholder, of course, incurred a risk with respect to this projected return; many projections of long-term interest returns were as low as 1½ to 2 percent.

On these policies, the policyholders still are receiving a rate of return of about 1½ to 2 percent. The stockholders, on the other hand, are realizing a return of 20 percent or higher. The policyholders, who enjoyed guarantees of cash values, premiums, and death benefits at the time of purchase, have not benefited from the subsequent economic changes. The stockholders who bore that risk have benefited. However, for small policies issued in the late 1940s, the stockholders probably are not realizing any profits because of increased maintenance expenses.

Since the relationship of stockholder and policyholder projected returns has changed so significantly over the last thirty years, should the policy be adjusted in some fashion to provide an increased return to the policyholders?

Is a 3 percent rate of return to a policyholder reasonable when new money rates are 18 or 19 percent? Is that return reasonable in view of an 8½ percent return on the insurance industry's total portfolio? Policyholders have the opportunity to renegotiate rates of return by lapsing their policies or borrowing the cash value in conjunction with the purchase of additional insurance. Stock companies are considering carefully whether some kind of unilateral bonus would encourage policyholders to maintain their policies rather than renegotiating by lapse or borrowing.

Equity is a matter not only between policyholders and stockholders but also among generations of policyholders. The appropriate 2 percent internal rate of return on a 1940s policy compares to 4½ to 5 percent for a policy issued in the mid-1970s. This question must recognize that policies purchased in the 1940s have produced a portfolio yield that is somewhat less than those purchased in the 1970s, although the rollover of the investment portfolio limits this difference to ½ to 1 percent. More

importantly, in a stock company, as opposed to a mutual company, policyholder contractual arrangements are independent of each other. As a stock company contracts with one policyholder, the existing relationship with another policyholder is not affected. In contrast, a mutual is an aggregation of policyholders, each with a type of ownership right. The treatment of one class of policy does affect the financial results for other classes if only because the residual value of the company is affected. In light of these definitions, equity between generations is not an issue for older nonparticipating policyholders.

How are these equity concerns addressed in the new adjustable-premium policies? With respect to the relative equity of policyholders and stockholders, the implicit promise in the adjustable-premium contract is that the company will maintain the expected future returns of these two groups at the same relative level as existed at issue. Of course, one of the strongest arguments for the adjustable-premium policy is its ability to accommodate changes in environment. As interest rates rise, the benefit goes to the insured by means of the premium adjustment. As mortality declines, the credit will go to the policyholder. Equity among policyholders of different generations will be preserved under these policies because the expectations of interest, inflation, and mortality levels must be the same, or at least very closely related, regardless of the generation of policy under consideration.

The adjustable-premium policy changes the relative equity between the policyholders and stockholders because it transfers some of the risk of change in the environment to the policyholder. That does not imply that the concept of equity for the older, nonadjustable-premium policies is inappropriate. For these policies, the entire risk was absorbed by the stockholder and the present profits represent a return on that risk.

MR. REISKYTL: While we have discussed some of the considerations in achieving equity, I am not sure we have defined the concept itself. Let us move on to consider how changes in the industry and the environment have affected equity.

MR. NORMAN E. HILL: Maintenance of "equity" is a much broader problem than simply choosing proper dividend levels for different classes of participating policyholders. It cuts across all lines of business, both participating and nonparticipating. Changes in the environment and in the industry itself must be considered in the determination of what is equitable.

The consumerist movement is an important environmental change. Policyholders are more insistent that their rights and benefits be protected, suggesting that some insurers may have abused some of these rights in the past.

Inflation is an environmental factor that has had enormous impact on the industry and on the financial situation of its policyholders. Not only has inflation eroded the value of fixed-dollar coverages but it also has sharpened perceptions about buying future benefits with current dollars.

Historically high interest rates have made policyholders much more conscious of rates of return on their insurance as well as of numerous attractive alternative investment opportunities. This is one element in the shift to more term coverages.

Consumers now place much more emphasis on current payoff than on long-term results. This mind set is very consistent with the "consume now - pay later" message provided by an inflationary economy. The "now" generation of college students has become our policyholders and prospects.

There are also a number of influences within the industry placing more emphasis on equity among policyholders. Additional cost-disclosure requirements have produced more sophisticated and less easily satisfied applicants and policyholders.

Many stock companies have been acquired by insurance company groups or outside conglomerates, with greater emphasis on short-term profit results for the stockholders.

The higher proportion of term insurance at lower and lower premium rates raises questions of equity between new and existing policyowners. When a company introduces lower term premium rates, what obligation does it have to lower the term premiums for existing policyholders and what will be the implication if it does not?

We have a number of new products that raise new questions in treating policyholders equitably. Rich Murphy already has discussed some of these questions with respect to indeterminate premium products. How can policyholders be treated equitably with products having both premiums and benefits unallocated and unguaranteed - such as universal life and flexible premium annuities - and with products whose benefits vary automatically in response to separate account investment performance - such as variable life and variable annuities? It would seem that we should give careful thought to the allocation of investment income, expenses, and mortality in products of this type.

We have seen considerable blurring of the differences between participating and nonparticipating coverages as a result of the widespread use of excess interest and indeterminate premiums on new nonparticipating products. The use of unallocated fund accumulations on many new products even has erased the clear distinction between life insurance and annuity products.

The substantial increase in policy loans has created severe equity questions that have been documented elsewhere.

Finally, the fact that the benefits derived from equity-related products do not respond automatically to inflation has lead to equity questions in the minds of many consumers.

The industry faces substantial challenges in responding to the equity considerations of these changes.

MR. MURPHY: Equity requires only fairness in dealing among various parties; it does not require equality of results. If policyholders are given equal options, it is not the responsibility of the insurance company to guarantee that each policyholder exercises those options in a manner as to create an equal result.

The interest rate is the most important environmental factor affecting equity today. Those who borrow on their policies to invest at current rates undoubtedly are receiving a better financial return than otherwise similar policyholders who leave the cash values with the insurance company. To the extent that each policyholder has had the right to borrow against his policy, equity has been served. Clearly, the variable policy loan interest rate will create a more equal result between policyholders who borrow and those who do not. However, I do not believe that this necessarily represents a significant change in equity.

Changes in the nonforfeiture law have resulted in a steeper cash value scale by duration for most nonparticipating policies. This produces a significant change in the relative equities between policies that terminate and those that persist. Since the new cash value scales are more consistent with the accumulation of assets underlying the block of business than were the old cash value scales, equity seems better served by the change.

The introduction of smoker and nonsmoker rating classifications seems to improve equity for new policyholders but it introduces a different question for existing policyholders. If a nonsmoker discount is offered to old policyholders upon application, has there been a change in relative equity within the old policyholder group? There seems to be no distortion of equity for old nonparticipating policies since the smokers are still enjoying their guarantees and the nonsmokers are somewhat better off than the guarantees. However, this approach is basically an abatement of premiums and may be considered inequitable under some state laws.

There are several types of adjustable-premium policies available today. Some fully guarantee mortality only while others guarantee mortality and expenses. Disclosure is extremely important so that potential policyholders understand the extent of their participation in future risks and so that they may properly compare the policies that are available. Serious questions of equity can arise however. If the company chooses to add a nonsmoker discount to an adjustable-premium policy, is it equitable to do so retroactively? It seems inequitable to the smoker, who originally anticipated a homogeneous classification, to redefine the adjustable-premium class to reflect smokers and nonsmokers. Of course, it might be possible to provide a nonsmoker discount from the adjustable premium if that discount is derived from profits that previously were taken by the company. That is, the combined smoker-nonsmoker mortality might always be used in determining the mortality assumption for the smoker class. This approach actually would benefit the smoker since the nonsmoker discount would attract an increasing number of nonsmokers and the mortality ultimately would decline. In general, however, there are significant risks to equity whenever a new rating class is introduced after issue.

MR. DICKE: From what has just been said, it appears that different paradigms apply to participating and nonparticipating situations. For mutual company participating policies, the degree of equity achieved among policyholders depends on actual results. The goal to provide insurance coverage "at cost" cannot be satisfied simply by providing equal options. In fact, the mutual company may be concerned that a policyholder might use the policy loan or nonforfeiture provisions of his policy to obtain coverage below cost, that is, at a rate supported by subsidies from other policyholders.

Policy loans were discussed in a separate session so I will not discuss them in any great depth. There are two particular aspects of the policy loan question that are unique from an equity perspective.

First, the policy loan utilization patterns vary in ways that suggest that sophisticated policyholders are benefiting at the expense of others. For example, at my company, over 60 percent of the available loan values for $100,000 policies are borrowed, while this rate is less than 20 percent for policies of $10,000 or less.

Second, policy loans are a matter of individual choice. The policy loan provision cannot be considered an "insurable risk" in the sense that the outcome of a large group of such "risks" is predictable. The borrower takes money from the pooled assets and pays a lower rate of interest than could be achieved in the market. Under the traditional dividend structure, borrowers receive insurance at less than cost while nonborrowers pay more than cost.

The policy loan problem has been the subject of a detailed study by Messrs. Reiskytl and Kraegel. The related problem of voluntary terminations has not been treated so fully. The legally-mandated cash value often does not accurately represent the current net value of the policyholders' contributions. For surrenders in the early durations, for example, acquisition costs may not have been amortized. In later years, the cash value, which is calculated on a book value basis, may not match the market value of the assets that back those cash values. In the current high-interest-rate environment, a surrender produces a market value loss of perhaps 25 percent of the value paid out. As long as the company's cash flow is positive, this market value loss is not realized directly but is taken as an opportunity cost, equivalent to the substitution of old, low-yielding assets for cash that could have been invested at current rates. The opportunity to make the current investment is transferred to the terminating policyholder. On the other hand, if interest rates decline after issue, the surrendering policyholder may receive less than market value. The persisting policyholders participate in the loss or the gain that results. In the current environment, losses will occur and future dividends will be reduced accordingly. The most fearful result could be a spiral in which the worsened dividends lead to increased surrenders so that at some point the remaining policyholders are left holding a relatively empty bag.

Those are a couple of the major problems related to the legal provisions of policies. The current economic environment also has lead to experimentation with new product forms. The most fascinating, in many ways, is

universal life. Universal life has been developed to meet perceived consumer desires for an unbundled life insurance policy with the investment insurance elements separated--while still maintaining the tax advantages of the traditional product. The impact on equity comes from the decision to offer universal life in conjunction with a portfolio of traditional participating policies through a tax-advantaged subsidiary.

There is also a problem in the transition to the subsidiary environment. For example, a big diversion of premium income from the parent greatly reduces the cash flow--with negative impact on the new money rate and consequently on the portfolio rate. This has to be treated very carefully to avoid an inequitable result. A company can continue to infuse surplus into a subsidiary for a long time, maintaining pressure on the cash flow of the parent.

These concerns revive the question of whether subsidiary policyholders should be treated as stock company customers or as equivalent to the mutual company policyholders. Even though the idea of equal treatment is superficially attractive, treating the subsidiary as an investment made on behalf of the participating policyholders of the parent might help define the appropriate profit targets for the subsidiary.

In a recent preprint, Dale Hagstrom suggested a pricing technique that would seek to equate marginal profitability for all "risk ventures" of the company, including product lines, investments, administrative improvements, and so forth. Clearly, two such risk ventures would be the line of parent company participating products and the line of subsidiary products. It may be that this is a basis on which to develop some sense of equity between the subsidiary policyholders and those of the parent company.

MR. MURPHY: Arnold, you note that you have a 60 percent loan rate for the larger policies and only a 20 percent loan rate for the smaller ones. I presume you do not recognize this difference in loan frequency in your dividends or in your premium rates. How can you justify this practice in view of the equitable concept of providing insurance at cost?

MR. DICKE: I can not particularly justify it and was a little surprised to discover that no one does it. I think that some of the other approaches probably are going to be more fruitful in dealing with the problem of policy loans in a way that can be handled in the marketplace. But I think from an equity point of view, it is a difficult question.

MR. WALTER MILLER: Arnold suggested that universal life stemmed from the desire of many consumers to have a product that unbundles the insurance and investment elements. At New York Life, we get a lot of communications from policyowners but we can not remember one single request for a product that unbundles the insurance and investment elements. I would like to ask how many people here have received requests for such unbundling from the public. (No hands were raised.)

Rich has asked how we possibly can justify not having direct recognition of policy loan utilization in our dividend scales. It really comes down to the way dividend classes are defined. Is it necessary to recognize

the degree of policy loan utilization in order to provide insurance "at cost" and is it necessary to have dividend classes that reflect this? This involves some of the basic philosophical underpinnings of participating insurance. How broadly or narrowly must I do my averaging? In the past there have been many situations where relatively broad averaging has become accepted as equitable and I am not sure that you necessarily have to bring in policy loan utilization as defining dividend classes in order to meet that criterion.

MR. MURPHY: Walt, if you will, let me offer another possible interpretation of why it is not done. A few years ago, most of us didn't recognize the differences in lapse rates or policy loans by policy size. Even though we probably found out about these things around the same time, almost all of us are recognizing lower policy lapse rates at higher sizes and not recognizing the differences in loans. That is, we do what is needed in order to be competitive in the market and the market is much more competitive at the higher sizes than at the lower sizes. This suggests that the pragmatic need to be competitive exerts a very significant influence on how we have interpreted the question of averaging and equity.

MR. REISKYTL: Walt, do you or the New York Life have guidelines as to when you recognize a differential? Could you espouse some principles?

MR. MILLER: I think the closest thing we have to a significant guideline is the feeling that you shouldn't change the rules in the middle of the game.

MR. CALVIN JORDAN: I am concerned that if you don't recognize the discrepancies between classes, those in the more favorable class will go where they can renegotiate the better deal, so that the less favorable class eventually will experience the same costs they would incur through a direct recognition of the unfavorable factor in the dividend. Furthermore, this forces the favorable class to pay new acquisition expenses.

MR. DICKE: I think you are right. Insofar as the market is efficient, you would not be able to do these kinds of things. Clearly, lack of information enables us to live with broad classifications. Our field forces would not let us have dividend scales that were less competitive for large policies than for small policies.

MR. LEWIS P. ROTH: I think you have to make a distinction between equity within a generation and equity among generations. Most major mutuals try to maintain equity among generations. If they are liberalizing a benefit--accidental death, waiver of premium, or something like that--most mutuals will extend the liberalization back to older generations. It is much more difficult to determine whether or not a part of a group should supplement the benefits of another part of that same generation. Some support Walt Miller's philosophy and others believe more strongly that policy loans should be a determining factor for dividend purposes. I do not believe there are any companies that do distinguish individually between borrowers and nonborrowers in their dividend scale for existing policyholders.

MR. REISKTYL: Franklin Life has been doing it for about a year. They recognize the actual borrowing on individual policies starting with the existing level of loans, for both new and old business.

MR. ROTH: Do you know if that has ever been challenged by any of the regulatory authorities?

MR. ELDON R. CANARY: No, it has not been challenged, but the Franklin is not admitted in New York.

MR. D'ALTON S. RUDD: The Canadian committee on dividends has just circulated the Canadian version of the Society draft. The Academy version is slightly different from the Society and so is the Canadian version. We have been getting our comments and--as is the Academy--we are being taken to task for being silent on the policy loan question and some others such as sex. In an earlier Society draft Tom Sutton tried to define the concept of expectations at issue. If there have been certain expectations at issue, are you not perforce bound to honor them?

If your 6-percent-loan-clause policies do not specify that dividends may vary by policy loan utilization, that cannot be changed later. If you did not differentiate by sex in a certain block of business, you cannot start differentiating by sex later on. We have not come to any decision but it seems an interesting concept, especially since some of our past dividend disclaimer clauses might prevent us from unbundling things that previously were pooled.

There is one other problem with the policy loan question. Like Mr. Roth, we believe in a common approach to all generations except that there is no commonality between generations when the issue series have different components. For example, the policy loan in our country has been fully variable since 1968. That's a very different provision that is not carried across all generations. I agree that there should be equity among generations when the policy form is the same.

MR. REISKYTL: Norm, would you tell us if replacement activity is a cause of inequity or if it leads to inequity?

MR. HILL: Let me talk first about what may be causing inequity. After our attempt to define equity, I think we ought to focus on what policyholders may perceive as equity. I would argue that they often perceive equity as receiving as good a deal as new policyholders of their company or as policyholders of other companies. As a result, even though they may not use the exact term, they may perceive inequity from situations such as lower premiums for new policyholders even though they may ignore cash values and dividends in the process. They may see new term insurance rates being less than older permanent rates and they may see newer, healthier renewing term policyholders paying lower rates than other term policyholders. They see higher rates of return for new policyholders such as universal life buyers. This is especially a problem when the rate of return is perceived as merely a form of tax-free interest credit. As a result, the rate of interest that does get employed in the actual dividend formula gets overlooked. And then there is the perception of inequity resulting from articles on universal life insurance in national publications, favorably comparing new products against the old products.

We can document the increase in lapses and the increase in policy loan utilization. It is less easy to document a correlation between loans and replacement activity but there is a general feeling that replacement activity is on the increase. So I would argue that a high level of replacement activity does result from these perceptions of inequity.

Considering whether this causes any inequity between classes of policyholders, we have policies with loans getting the same dividends as those without loans. Companies may sometimes have to liquidate assets at losses in order to realize the funds to pay surrenders, and this may involve the use of funds from one class to pay for surrenders of another class. Policyholders who have not lapsed or utilized the policy loan may be less sophisticated, may have smaller policies, and may even be in poor health. Some policies sold in the general account may provide high expectations with respect to interest credits. Sometimes these interest credits are guaranteed and sometimes they are not. But if these high interest credits are to be made a few years after issue, it may be at the expense of other classes, since most companies do not allocate their assets by line of business or product line.

MR. REISKYTL: Norm, do you have a two-sentence response to the question of whether replacement results from inequity or causes inequity?

MR. HILL: I say the answer is both. The high level of replacement activity does result from perceived inequity, whether it is actual or not. There can be a vicious circle so that that perception and the resulting replacement activity may be one of the causes of further inequity.

MR. REISKYTL: Let's move into the last question and one that may be of broader interest. What strategies are companies adopting?

MR. DICKE: I am supposed to discuss the strategies that involve dividends. Naturally, dividends are going to play a major role in any program aimed at maintaining equity. Consider the policy loan problem. Most companies are varying dividends by contractual policy loan rates already and it is possible to reflect utilization by policy size, although few companies are doing so. The ultimate strategy based on utilization is the direct recognition strategy advocated by Jim Reiskytl and Wil Kraegel in a paper a few years ago. At least one company has adopted this approach and others are going to.

A new approach now is becoming possible through legislation that allows for variable market-linked loan rate provisions. One strategy that would be possible under these provisions would be to permit a choice between a fixed rate, perhaps 6 percent, and the variable rate. Then, in effect, the future policyholders would be able to choose their dividend class. Rather significant differences in interest-adjusted net costs can be developed between the fixed and variable policies. In the case of an age 35 whole life policy, we produced a difference of $1.75 in twenty-year interest-adjusted net cost.

With that kind of strategy, it is important that the 6 percent policies, that obviously will be heavily borrowed, are not combined with older policies unless the older policies are given some right to exchange for

variable loan rate policies. It would be really unfair to combine policyholders who are opting for a particular policy provision purely because they want to borrow with a general cross-section of policyholders who got the only loan provision available when they bought their insurance.

There do not seem to be any such straightforward strategies for dealing with the surrender problem, which I still think can cause equity problems. Steeper cash value scales and termination dividends that are not payable in the early years can help deal with the problem of nonrecovery of acquisition costs. The problem caused by the fixed, book-value nature of cash values is more difficult. It could be addressed by varying payouts to terminating policyholders based on the spread between market interest rates and the dividend interest rate applicable to the surrendered policy. On the other hand the cash values are fixed by law. Although these regulatory obstacles would have to be overcome, these fluctuations in market value could be recognized through termination dividends. According to the Academy's dividend recommendations, "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 in force at the time of the termination of the policy." In valuing this share, the use of book value presumably is justified on the assumption that there is an ongoing enterprise. Using a "termination-of-business" basis, that is, market value, would seem more equitable to me.

Even considering market value adjustments, older policy series may be receiving too little through the fixed cash value. If termination dividends are introduced for a new series, should older policies also receive them? Another question of strategy is how older policyholders can be convinced that they have been treated equitably. Illustrations of replacement vehicles such as deposit term, term-annuity combinations or universal life will not be comparable to those provided at the time of issue. Even if those illustrations were revised to reflect the current dividend scale, they would not be comparable. I wonder if it might be possible to offer illustrations that in some way reflect an "apples-to-apples" comparison of the existing policy to a proposed replacement.

Northwestern Mutual has developed a brochure that shows the projected effect of continued high new money rates on their portfolio-average based dividends for new policies. I wonder if similar demonstrations would be permissible and valuable in helping existing policyholders to determine whether they have received equitable treatment.

MR. REISKYTL: Rich, you have an indeterminate-premium approach to solving this problem. How effective is it in maintaining equity? Will it reduce your replacement rate?

MR. MURPHY: We introduced an adjustable premium policy to preserve the policyholder-stockholder equities better. The adjustable premium allows anticipated future increases in interest or reductions in mortality to pass through to the policyholder. We have adopted the adjustable premium policy concept for both permanent and term insurance. On all of our policies issued since 1976, we have given the option to surrender

for an adjustable premium policy. These policies all had the same cash value scale as the adjustable premium policies. Along with the option to exchange, we allowed the policyholder to increase the face amount to maintain the same premium. For most policies this resulted in a 15 to 20 percent increase in face amount without any additional underwriting. The frequency of election of the new policy was very disappointing.

Because the original policies were sold through the agency system, we made the exchange offer through the agent rather than contacting the policyholder directly. There was no agent compensation involved in the exchange, which partially explains the low election rate.

Since adjustable-policy premium rerating is basically at the option of the company, it is important that there be some procedures for guiding equitable redetermination of the premium scale. A Society of Actuaries committee is developing certain principles applying to the redetermination process that will be similar in content to the principles for dividend scales of mutual companies.

There are several major concerns with respect to equity in the redetermination of the premium for adjustable policies. First, should the expectations as to future interest and mortality be the same between generations of policies? Remember that adjustable-premium policies always relate to future expectations. The ACLI guidelines require that rerating not discriminate unfairly among the same or different generations of policies. That rather vague wording is not likely to be interpreted consistently from actuary to actuary. However several states do require that the assumptions used in the rerating be at least as favorable as those employed for new issues.

This wording seems to provide very significant safeguards in preserving the equity among policyholders of different generations. Because the adjustable premium policy cannot consider the experience of the past, but only can adjust to accommodate changed expectations with respect to interest, mortality or expense, it seems that the equity between generations will be safeguarded without any guidelines of any type. However, there are many situations such as a change in tax phase that <u>can</u> significantly alter the equity between generations.

Another risk is the possibility that insurers will isolate blocks of policies based on changes in health. Almost all of the interderminate policies include wording to the effect that no change in avocation, occupation, or health will be reflected in the premium rating action. ACLI guidelines and most state guidelines require that base rates be determined without regard to any changes in health status.

One of the greatest potential abuses of the adjustable premium concept is that companies will not change the rates as frequently as implied. We have seen companies maintain dividend scales for twenty years even in light of the increased interest rates. Several states and ACLI guidelines applying to adjustable premium policies require that assumptions be reviewed when every new rate series is introduced or, in any case, at least every five years.

Although these general standards relating assumptions to new issues, forbiding changes in rates on account of changes in avocation, occupation or health, and requiring that the assumptions be reviewed periodically set the tone for the preservation of equity, the detail of applying the rerating process will give ample discretion to the companies. Will the original profit assumptions be preserved for each age and amount group? Will some overall profit goal be used and rate changes allocated by age and amount according to competitive need? Is one approach more equitable than another? We must rely on the good faith of the participants to a contract to carry out their respective responsibilities.

The ACLI guidelines for adjustable premium policies require that the actuary perform certain functions at the time of policy submission and at the time of rerating. In a very real sense, this requires that the actuary act to preserve equities. The guidelines specifically require that the actuary indicate that any rerating does not discriminate among policyholders of the same or different generations and that the risk classes are determined so that each class is expected to constitute a homogenous grouping with respect to the risk characteristics.

The adjustable premium policy, I believe, was just an initial stage progressing toward universal life concepts. For both of these plans, increased attention is being given to disclosure, both in the sales process and annually after issue. Fair dealing between the parties can be achieved only if the customer is adequately informed. Although we will spend a lot of time debating the relative merits of different interpretations of the nonforfeiture and valuation laws as they are applied to universal life and to the adjustable premium policy, those debates have little real meaning in the marketplace. It is much more important that we use our influence to make sure that there is adequate disclosure with respect to these policies. There should be a clear indication of the initial and maximum indeterminate premiums, a clear statement of the nonguaranteed nature of the projected premiums, an indication of the frequency of review of premium rates, and a presentation of policy costs on an illustrated and on a guaranteed basis. The flexibility of universal life premium payments and the insurer's right to establish the interest rate level to be credited requires annual notification to the policyholder. The notification must be meaningful and permit the policyholder to make an informed decision about future deposits and the disposition of the account.

MR. REISKYTL: Norm, what are companies doing unilaterally and bilaterally?

MR. HILL: A unilateral update program is an automatic company program for implementing numerous policyholder changes to a different type of coverage. This different coverage could include a rider, or a new policy form may be prepared to replace the previous contract. Death benefits for the new coverage usually are increased 10 to 20 percent; this increase in death benefits seems to be the major factor in maintaining equity or the appearance of equity and avoiding replacements.

Other aspects of the old life insurance contract would stay the same. There would be no change in guaranteed gross premiums and cash values would not be reduced in any future policy year, since the original scale of cash values is contractual. A policyholder loses no guaranteed benefits such as policy loan interest rates or settlement options.

These updates may be made on either an original-age or an attained-age basis. For an attained-age change, the company must capture the current date and age for its inforce records. While advance state insurance department approval is required, the departments will at least listen favorably to requests for unilateral updates. They may not be completely comfortable but they will listen. Approval should be obtained in each state in which the company contemplates updating policies. The New York insurance department seems to be one exception to this pattern; they have indicated that they will tend not to approve any unilateral updates. However, they may be willing to modify this position if the company commits itself to retaining the old dividend scale or a dividend scale at least as favorable. This may be difficult to do in connection with an increase in death benefits. Alternatively, New York might be agreeable to some type of negative affirmation--an update that takes effect unless the policyholder objects within a certain time limit.

To avoid any confusion, the policyholder probably would not be notified about all aspects of a unilateral change, although he likely would be notified of the increase in death benefits. Implementation of a unilateral policy change involves legal questions. One company evidently concluded that under current legislation such a unilateral change is simply illegal and impossible. If the updated policies are to retain the old cash value scale but reserves are to be modified to a higher interest rate, Section 6 of the standard valuation law (on the 1980 amendments) may be troublesome. This "linkage provision," as interpreted by most people, precludes reserve interest rates higher than cash value interest rates, regardless of the magnitude of reserves relative to the magnitude of cash values. To cope with that problem, the company has to modify the interest rate in the cash value formula while still maintaining the same dollar amount of future cash values. Of course, these reserves probably would be classified at a higher interest rate. For an original age update, the old reserves, which may have been at 2½ percent, now will be classed as 3½ percent or 4 percent depending upon the year of issue. For an attained age unilateral update, 4½ percent policy reserves could be used under the 1976 amendments.

Let's consider some of the mathematical complications that arise from such updates if the company wishes to maintain consistency among the dollar amounts of reserves at the time of update, the cash value amounts at the time of update, and the policy reserves anticipated for this block of business several years in the future.

For cash values, one approach might be a "greater of" test. A company could compute cash values on the new interest rate basis and keep a dual factor arrangement that would compare these cash values with the old scale, which has to govern. Now it is likely that the NAIC is going to have a regulation, perhaps in a year or so, dealing with contemplated excesses of cash values over reserves. In effect, this regulation is likely to require companies to reserve today for any future excess cash values. This would mean holding some type of additional reserves today--not as onerous as deficiency reserves probably--but still some extra reserves for any excesses in the future, whether ten, twenty, or thirty years from now.

This type of problem may be avoided by pegging equality in Fackler equation terms. Start with the old basis cash values and reserves and accumulate them at the new interest rate so they are equal to the new cash values and reserves at some future point. The unknown factor may be the net premiums, the death benefit, or the modified reserve basis expense allowance. It should be noted that the 1980 amendments do preclude any kind of constant drastic change in cash value premiums year after year. I think you can picture some of the complications that can result.

Some companies may wish to have fixed limits for death benefit changes; that is, the increase may be limited to 20 percent even if the calculation produced a 30 or 40 percent increase. That may be more than the company would wish to grant. There will be a significant cost to the company to provide a unilateral update. It must deal with state insurance departments, prepare new riders or policies (even if they are not submitted to the policyholders), and reconstruct the inforce file of the company to incorporate the new policy characteristics. If the update is effected through riders, the number of contracts in force may be nearly doubled. Even with today's computer technology, the total processing time may be a factor to consider. At least one company has completed a unilateral update and they did get approval from all the states. There probably are a few others. Several companies are in the process of obtaining insurance department approvals for this type of update, and several others are studying such an approach, which may become popular during 1982. A company should plan to maintain reserves at about the same level unless a change is part of a specific agreement with the insurance department. A significant unanticipated release of policy reserves will make them uncomfortable about the future course of the company.

In bilateral exchange programs, policyholders are solicited on a mass basis to obtain their consent to the change in coverage. The most well-known bilateral exchange program was implemented by the Northwestern Mutual. The characteristics of the new coverage are similar to those outlined for unilateral cases: higher death benefits, cash values pretty much the same, and other guarantees remaining the same. Preapproval of the insurance departments does seem appropriate even if not really required. An argument can be made that even the IRS should give prior approval to either type of update to avoid any future challenge of reserves due to a change in interest rates. The cost of implementing a bilateral program does seem greater than that of a unilateral update. The company must prepare request letters and home office representatives have to answer policyholder questions. In terms of maintaining equity, there seems to be a new class of policyholders arising from such a bilateral update. Those who accept the change should constitute the great majority, but there will be a group who reject it. The equitable treatment of this latter group is another concern.

Replacement offers for completely new coverage may be very similar to a bilateral update. Only a few companies have implemented an approach like this so far. Comparing the two types of updates, the bilateral seems more costly, but facilitates regulatory approval and minimizes objections since the policyholders will approve it in the first place.

Bilateral changes may produce a new class of policyholders, namely those who rejected the change. Unilateral updates made on an attained-age basis should be segregated from direct new issues. Some characteristics of the new coverage resulting from the attained age conversions may automatically segregate those policies.

There are equity considerations other than the increased death benefits. The company may wish to demonstrate that any tax savings resulting from the update will be shared with the policyholders. In that case, such savings may be easier to publicize under a bilateral approach since the groundwork has been laid by soliciting the policyholders about the change.

MR. DONALD B. MAIER: I'd like to touch on terminal dividends for a minute. At the Metropolitan, we explored the possibility of working with our terminal dividend system to see if we could get some relief from market value losses. We found out several things. One is that the idea didn't fit the theory because we have a charge in our dividend formula to build up surplus for antiselection on terminations. And the terminal dividends themselves must be a part of the fund that is there for long term trends. These two factors didn't seem to justify withholding terminal dividends at this time. Another major factor was that total terminal dividends just weren't that large in relation to surrender values so that a piece of terminal dividends wouldn't have much impact. Another factor is that New York requires terminal dividends to be the same on deaths and surrenders. And if you start to do this on inforce business, you really should do it in your dividend illustrations as well.

Metropolitan did update its industrial business unilaterally. First we did the paid-up plans. New York required us to demonstrate that every policyholder would be better off after the update than before. That would have been a lot more complicated on our premium-paying policies, so this year we are going to update our premium-paying industrial policies by waiving all future premiums. The cost of collecting premiums has been getting high in relation to the revenue anyhow, and we have been looking for the right time to waive all premiums on this business.

MR. SCOTT D. McINTURFF: New England Life is initiating a bilateral exchange program for non-pension permanent plans at the end of this year. It is going to be directed basically at three areas, maintaining equity between existing and new policyholders, reducing replacements, and decreasing cash flow problems resulting from policy loans. The program is designed to place existing policyholders on a basis consistent with that being used for new policyholders. Specifically, New England will offer to change the cash value and reserve basis to 4 percent 1958 CSO CRVM, to change the policy loan interest rate to 8 percent, and to increase the face amount of the policy by an average of nearly 20 percent without evidence of insurability. There is no explicit limit on the percentage increase.

In designing the program we started with the premise that we would not change the gross premium to maintain the billing procedure and to avoid the potential loss of renewal commissions by the field. The guaranteed cash value of the policy on the effective date is unaffected by the change.

Future cash values generally are higher for exchanged policies than for non-exchanged policies, although in a few instances, they may be lower for a number of years. Of course the cash value of an exchanged policy always will be higher than that of a non-exchanged policy at maturity.

Dividends for exchanged policies are affected adversely by the increased mortality risk and the increased investment return needed to build up the cash values at the 4 percent rate. Offsetting these two factors are the favorable tax treatment of the new reserve basis and the higher investment earnings from the 8 percent loan interest rate. In general, the combination of these factors produces higher dividends for exchanged policies than for non-exchanged policies. This is especially true if mortality plays a relatively insignificant part in the dividend. The slope of the dividends may change after the exchange. But the critical factor is that in all cases the exchange is an offer to provide more insurance at a lower rate per $1000 after considering dividends and cash value increases than was available prior to the exchange.

The program might be considered a way to improve equity between new and existing policyholders by making these improvements in the pricing of the new policies available to the existing policyholders and also to improve the company's cash flow position.

MR. REISKYTL: Is there any agent compensation involved with your change and are you doing it as of the original age or the current age?

MR. McINTURFF: There is compensation like a new first year commision for the agents. The formula is based on the old face amount of the policy, so the scale depends on the size of the policy. It is set up as an expense allowance and must be vouchered. I think that is necessary in New York.

We don't view the change either as an original-age conversion or an attained-age conversion. The formula to determine the increased face amount equates future benefits with the present value of future net premiums plus the funds that are on hand. Because some states were concerned that we could have a nonforfeiture loss, we expressed the point of view that it is neither an original-issue-age conversion nor an attained-age conversion. In particular, Wisconsin is still debating the issue.

The policy date will be as of the original issue age but we start with the funds that are on hand at the date of the exchange. Since those funds were built up in compliance with the nonforfeiture laws in effect at issue, we use this starting point to calculate actuarial present values.

MR. JON H. NICHOLSON: Northwestern National is instituting a unilateral update of some 35,000 nonparticipating policies issued at 3 percent and 3½ percent interest in 1963 through 1975. We have obtained two private letter rulings, applying to the company and to the policyowner. The new amount of insurance will be based on equality of reserves at the point of change. There will be no change in the gross premium, and no compensation will be paid to the agents. The cash values as well as the paid-up or extended term values will be the same as or greater than they were on

the original policies. The maximum amount of new insurance will be 25 percent or $25,000, whichever is less. The average increase will be between 15 and 20 percent.

We are instituting the program with equity in mind. Also, the replacement problem motivated us, and we are hoping that these policies will be more tax effective.

MR. REISKYTL: Why did you feel that a nonparticipating policy ought to be updated?

MR. NICHOLSON: I think our board presentation stressed the equity problem, improved the persistency and stemmed the replacement problem.

MR. DICKE: If the future replacement problems are going to involve universal life and products of that nature, where the rate of return is an important feature, will this kind of program really be effective?

MR. NICHOLSON: Probably not, but we are having to assume that these policies may never be touched by universal life. Many of them are small and may not be replacement prone. But there is an increasing replacement problem and this update will not guarantee that these policies will not be replaced.

MR. MURPHY: Jim, can you tell us something about the Northwestern Mutual lapse experience as you went through the update offer? Did it work to decrease lapses or did lapses increase as a result of the increased publicity?

MR. REISKYTL: We just finished our program earlier this spring and our experience is too new to know yet. We have had an increase in lapses, but this was observed prior to the update effort.

One of the interesting things that we learned was the type of policyholder that the A. L. Williams operation was able to influence. While two-thirds of all eligible policyowners accepted our update offer, only 30 percent of those who dropped our policies to go with A. L. Williams had previously updated. Apparently we did not reach these people through mail or agent contact; we wish we could be more effective in our communications to those policyowners.

MR. EDWARD F. DALTON: Phoenix Mutual has announced a program that will update most of our inforce policies as of the 1982 anniversaries, using an approach similar to that of Northwestern Mutual. We have both level-interest and split-interest reserves in force so we are updating the level-interest policies to a level 4 percent and the split-interest policies to 4½ percent - 3½ percent. This will put the inforce policies on the same basis as our 1980 policy series. The policyholders will receive complete illustrations providing an explanation of the program and individualized comparisons showing death benefits, cash values, and dividends year by year over the next five years, and for each five years thereafter.

Because we are taking the "negative affirmation" approach, we felt it necessary to structure the change more like the unilateral programs described by Mr. Hill, providing no reduction in any guaranteed benefits.

For no change in gross premiums, the increase in face amount probably will average about 15 percent, but for recent issues at very young ages could go as high as 45 percent. Also, we are guaranteeing that future cash values will be at least as high as they would have been without the update change. We are not providing any compensation to the agent and the approach could be characterized as an original-date change. Future cash values and reserves on the updated policy will be the same as those for a policy issued from the original date at the issue age.

These are all participating policies. We are equating the relative profitability of updated and non-updated policies and determining dividends to meet that requirement. Generally, the dividends are comparable but they tend to be lower at the higher ages where the mortality cost becomes an important factor.

MR. REISKYTL: Does this mean that the absolute dollars of dividend will be the same as for the existing scale on current business?

MR. DALTON: Some changes are being made in the structure, although we did not recognize federal income tax differences as fully as Northwestern Mutual did. That will be built into the dividend scale in the future. We did not use the current scale as a floor; there can be a reduction in dividends.

MR. EDWIN E. HIGHTOWER: We are implementing an update program at Government Personnel Mutual in San Antonio, effective in December of this year. It will be like the Northwestern Mutual program in that we will be going to 4 percent and that the basic policy will be increased and additional paid-up insurance granted. It will be similar to the Pan American program in that it will be on an implied consent basis; the policyholder will have to reject it to prevent it from taking effect. The policy loan interest rate will not be updated. Dividends for calendar year 1982 will be the same whether or not the policy is updated; however, there probably will be some slight future reductions in individual policy dividends on the updated policies as compared to those not updated. Approximately 52 percent of our total individual ordinary policies are eligible. The total increase will be between 15 percent and 25 percent varying by policy. These are 2½ percent CRVM policies issued between about 1947 and 1974.

Our field force reaction has been positive to date. There will be no field compensation on the program, nor any direct field involvement in the implementation. We do hope to get some favorable sales results from it.

MR. DICKE: Is there anyone here whose company might have considered getting into the universal life business or one of these other new generation products and considered just what would happen in terms of replacement? Will you do anything systematic about it?

We will be introducing a universal life product in our company and we investigated the possibility of offering an exchange just to see how bad it would come out. For example, we tried to rewrite the old policies to a paid-up basis with the change of reserve and so forth, and have the new premiums go into the new policies, with pretty bad results.

MR. THOMAS C. SUTTON: Whenever the subject of update comes up, our agents seem to have fairly recent business in mind, and their objective is to apply nonsmoker discounts to existing business. That subject really has not been addressed here and it is not clear to me how that can be done.

MR. MURPHY: We agree that replacements are a problem; that is why we offered the exchange to 1976 and later policies. The lack of response without any commission leads us to believe that even if you give the agents a reason to go back to the customer for sales of additional insurance, it will be difficult to motivate them without paying them well for that update effort.

MR. REISKYTL: We've looked at this from two viewpoints. If we do not offer an exchange for term insurance, the policyholders will get their nonsmoker credits simply by replacing the policy. Accordingly, when we recognize smoking for the first time in 1982, we plan to permit current renewable-term policyholders to convert to the new basis. On the other hand, we do not think it is practical to provide a nonsmoker credit on existing business without a way of identifying the nonsmokers. If we were to ask our existing insureds if they smoke, we believe we should seek other underwriting requirements as well, and we cannot afford to reunderwrite two million people. Furthermore, the resulting differential is relatively small. I believe Phoenix Mutual gave a nonsmoker credit to some existing business; perhaps Ed Dalton would like to describe it.

MR. DALTON: When we removed the build requirement for our nonsmoker premium credit, we did offer to extend the premium reduction to policyholders who were nonsmokers at the time they applied but were not eligible by reason of build.

I might add that we are not doing anything about policy loan interest rates in our update as New England is. Our primary purpose for doing the update is to achieve the tax savings so that our policyholders can get insurance at lower cost. We felt that any negative in the process would produce a lower acceptance ratio and would preclude the possibility of using the negative affirmative approach.

MR. REISKYTL: The Northwestern Mutual separated the update from the policy loan rate change. Our acceptance on the policy loan offer was about one-third while the acceptance on update without any policy loan impact was two-thirds. Combining the two obviously would make a very attractive offer. Would they accept the new policy loan provision to get the increased coverage?

MR D'ALTON S. RUDD: I would like to ask Mr. Murphy why the factors for the adjustable premium contracts were prospective only. This is a matter of theoretical consideration for the committee that is considering guidelines in this area. Using analogies to guaranteed renewable individual health, some feel that this should be retrospective as well as prospective. Actuaries should have a chance to think about this before it gets enshrined in the literature. Should the shareholders' profit on these gains be standardized at the same time?

MR. MURPHY: We had enough arguments with the insurance departments about the difference between a dividend and a change in these premiums that our standard response is that it always has to be prospective and not retrospective.

In my opinion, it should be prospective because we should be talking about future new money rates. Some companies are establishing their formulae to reflect a portfolio rate and future changes in portfolio rates, which is equivalent to a retrospective examination of those interest rates. Other formulae are based on a new money rate which is basically prospective. A portfolio rate with projected changes in that portfolio rate is not a proper way to handle this particular policy.

I do not believe the stockholder returns should be standardized but I think it would be very wise if the companies were required at time of rerating to maintain their returns at the same level or to relate them to the changes being made with respect to new policyholders. How can we prevent the stock company from increasing its profits over time, destroying the original relationships between the policyholder and the stockholder and allocating a much larger proportionate share of the return than originally anticipated to the stockholder? One way to do this is to relate those future assumptions directly to the assumptions for new business issues. This provides a very good control on the return to the stockholders. But in practice that really is a difficult thing to do.

MR. MILLER: As a member of the dividend committee, I also am struggling with the question of a retrospective or a prospective approach for the adjustable premium policy. I would agree with Bill Rudd that from the standpoint of pure actuarial theory and proper actuarial practice there is no reason to be constrained to a prospective approach. While the variable premium policy is a relatively new development, the professional actuarial bodies, by their failure to establish reasonable standards and guidelines in time, left a vacuum which very naturally was filled by others who have adopted regulations that we would rather not see. And whether the Society committee does or does not endorse a retrospective approach to rate redetermination, the fact of the matter is that a number of state insurance departments got there first and the force of their action is going to override whatever might have been and would have been had we acted promptly.

MR. REISKYTL: At least, Walt, as you know, we are moving much quicker than we did in the mutual company area, and if we can agree soon among ourselves, we may still be able to influence the remaining states, but your point is well taken.

I would like to go back to my beginning statement that equity was something you do if--if you have to or if you can. Northwestern Mutual is in the latter camp; we do not believe we are restricted by the categories established at issue and do believe that the only limit on equity ought to be practicality. If you know that one factor that you are not recognizing has a larger impact than another factor you are recognizing, don't you have an obligation to recognize that factor? The best example that comes to mind is policy loans, where many companies are differentiating among 5, 6 and 8 percent. I suspect the differential impact between the borrowers

and nonborrowers is many times the differential they are recognizing. This may or may not be done for many reasons, but if we really looked into the dividend allocation, there may be things we do not recognize that have more impact than those that we do.

To conclude this particular session, the Northwestern has done an update program and is now in the process of planning our next one, which will be available beginning in 1983. Since the time has run out, I am sure you do not want to ask any questions about that.