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ACTUARIAL OPINION ON NON-GUARANTEED ELEMENTS

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MR. WILLIAM T. TOZER: The recently filed 1987 NAIC Convention Blank required major changes for nonguaranteed element products. On page 11 following Exhibit 8, an Interrogatory was added that asked if a company issues or has in force policies that contain nonguaranteed elements. If so, attach a statement that contains (A) the determination procedures, (B) the answers to the interrogatories, and (C) an actuarial opinion as described in the instructions.

We have a well-informed panel on this subject. I had the privilege of chairing the American Academy Task Force on Nonguaranteed Elements that developed the actuarial guidelines, the interrogatories and actuarial opinion that are now required for the NAIC Convention Blank. Mark Tullis is a Member of an American Academy Task Force responsible for publicizing these actuarial guidelines and interrogatories. Larry Robinson is the Chairman of the ACLI Subcommittee on Cost Disclosure. As a result, he has been very active in the area of sales illustration with nonguaranteed elements.

MR. MARK A. TULLIS: I would like to go over what the new requirements are for nonguaranteed elements. There is a new question in the Annual Statement which must be answered: "Does the company at present issue or have in force policies that contain nonguaranteed elements?" If yes, the Annual Statement must contain a statement of the determination and redetermination procedures for the nonguaranteed elements. In other words, how did you get the nonguaranteed elements in the first place and how are you going to revise them when the need arises? Also, the statement must include the answers to eight interrogatories. These have to do with things like whether any of the nonguaranteed elements have been changed this year, whether actual experience is like what was assumed when the products were originally priced, whether the product illustrations are supportable, and how they tie in with actual experience. Finally, the statement must also include an actuarial opinion that the nonguaranteed elements conform with Academy recommendations. Together these items are designed to ferret out companies with misleading illustration practices or with unrealistic, unsupportably priced products.

What sorts of contracts are subject to these requirements? Most annuities, universal life contracts and indeterminate premium life contracts are covered as well as single premium life contracts and term life, if these contracts contain nonguaranteed premiums or other nonguaranteed elements. The Annual Statement Instructions specifically state that excess interest whole life, which is another name for fixed premium universal life insurance, is covered by these requirements.

At first glance, it appears that both determining what is required and fulfilling the requirements ought to be relatively easy. To test this, I identified the top 80 U.S. life companies by direct premium written. I then got copies of Question 3 on page 11 from the Georgia Insurance Department as well as copies of the applicable nonguaranteed element attachments. Of the top 80 companies, one was not licensed in Georgia. Three answered no to the question, "Do you at present issue or have in force policies that contain nonguaranteed elements?" This is interesting. Apparently all three of the companies actually do have non-guaranteed element contracts. One of the companies sells single premium life, annuities and fixed premium universal life and advertises that they pay money market rates. The other two companies have universal life products listed in a national publication. One of the two companies contributes to a semi-annual universal life product survey of a national magazine. It appears that these three had trouble answering the question.

Two of the companies didn't answer the question. Seven answered YES, but did not include the required attachment. Two of these companies indicated they only filed these items with their state of domicile. I could find no mention in the NAIC Annual Statement Instructions that these items were only to be filed in one state.

Of the top 80 companies, 67 answered yes, and actually included responses to the interrogatories. As a result, my data are based on these 67 companies. My goal is not to embarrass particular companies, but to examine industry trends. My examples of specific responses have been paraphrased so that companies would not be identifiable.

The first requirement was to attach a statement of the determination procedures for nonguaranteed elements. These statements varied in detail from company to company. A number of the companies treated the attachment like the dividend requirements, listing individual nonguaranteed elements by duration for different products. Some companies included underlying assumptions, such as interest rate spreads. However, these companies were in the minority.

A typical response, which is fully within the spirit of the requirements, describes how the companies calculate the nonguaranteed elements without giving specific details. It says, "Nonguaranteed elements are set solely at the discretion of the company. These determinations are based on (1) the projected profit margin using anticipated experience factors and (2) competitive considerations. Pricing for these elements is accomplished by an asset-share method with all elements combined and analyzing total profitability and competitiveness. Any adjustments would be based on prospective anticipation of varying experience factors." The important points the response indicates are: (1) the nonguaranteed elements are at the discretion of the company; (2) the important items in determining the elements are profit levels and competition; (3) how profit is measured; (4) all elements are combined in determining profitability, so that there is no one-to-one correspondence between, for example, mortality experience and cost of insurance rates, as might be implied by the wording of the interrogatories; and (5) profits are determined on a prospective basis.

On the other side of the coin, a number of companies answered the question in such a way that virtually no information is discernible from the answer. One example says, "Cost of insurance rates for universal life policies may be changed at any time. The most significant factor causing the change would be expected mortality costs." This is the complete response. It did not address interest, lapses, expenses or any of the other items, only cost of insurance rates.

Companies vary greatly in their interpretation of the determination procedures. However, this requirement may be ambiguous. There are no instructions or guidelines as to the level of detail required. On the other hand, the eight interrogatories are mostly yes or no questions with follow-up. There should be less ambiguity in the answers to these interrogatories.

I focused on Interrogatories 4 and 7. They ask whether current experience is different from that which was used in pricing the nonguaranteed elements. If so, how? And is there a substantial probability that illustrations authorized by the company cannot be supported by currently anticipated experience? Together, they measure whether the company is meeting its pricing assumptions and whether any improvement in, for instance, mortality or interest spread, was assumed in pricing. Examples of items which should cause affirmative answers to Interrogatories 4 or 7 include (1) expense overruns, that is, actual expense in excess of what was used in pricing, (2) lapse rates higher than assumed in pricing, (3) pricing which utilizes mortality improvement, and (4) current interest spread which is lower than what was assumed in pricing.

A review of the industry press would lead one to believe that, except for maybe the third item, these are issues which are pandemic in the insurance industry. To quote Bradley Smith from the May 1988 issue of *Best's Review*, "Life insurers have been systematically underpricing their products in recent years." Peter Walker with MacKenzie & Co. wrote in "Market Facts" that "The actuary plays with assumptions about investment spread, expenses, mortality, and persistency until he can produce an equation that yields the 15% ROE. In most cases, however, these assumptions bear little resemblance to reality." He later states, "Over the last four years, many companies have offered credited rates that far exceed new money rates. How long can that go on?" And finally, he says that despite what might be assumed as a pricing spread, "Today's real world spreads are closer to 0 to 50 basis points." Finally, relative to the expense factors assumed in pricing, Bob Stein stated in an article in *Resource* magazine, "For a great many companies, expense levels are in excess of the provision within product pricing." I think it is fair to say that these three individuals are in the mainstream of thinking about the industry today. The insurance press is ripe with articles about expense overruns, excess lapses and low investment spreads.

It's reasonable to assume that most of the companies surveyed would have identified some of these problems in their answers to Interrogatories 4 and 7. I went through and tabulated the results. In many cases, it was really difficult to determine whether the answer was yes or no. For example, one company responded to Question 4, "Experience factors are based on the company's expectations. For some factors, current experience is the best estimate for the future, and for some factors, it is not." What does this mean? It could be paraphrased as, "We refuse to answer the question."

I went through 67 responses as best as I could. I found that 15% of the companies indicated that they had an expense overrun. That means that 85% apparently have no excess expense problem. Twelve percent assumed mortality improvement in pricing. None of the companies have an excess lapse problem. Nine percent of the respondents are not currently earning their investment spread. This means 91% of the companies are apparently meeting their pricing interest. Accounting for double responses, I found that 73% of the companies are currently meeting their pricing assumptions, don't price with mortality improvement, and have fully supportable product illustrations.

These results are inconsistent with the industry press. I have no doubt that some of the top companies are fully meeting pricing assumptions. I question whether that number is anywhere near 73%. It's more realistic to assume that many of the 73% either misunderstood or otherwise answered the question incorrectly. I called two Chief Actuaries for State Insurance Departments. Both responded that they were understaffed, would monitor the new requirements as best they could, primarily for domestic companies or companies against whom complaints had been lodged, and that much of the monitoring would be done in conjunction with triennial examinations.

What are the implications for this? Enforcement will be spotty by states, as many states do not have the expertise to monitor these responses. Those that do are going to concentrate on the domiciled companies. For some of the interrogatories, there will be effectively no enforcement. It is not easy to determine whether a company is in an expense overrun position. The sort of analysis which is required is not currently performed as part of the triennial examination. A great many companies have no idea whether they have an expense overrun, so it is not reasonable to expect State Insurance Departments to monitor the question.

Finally, interrogatories cannot be relied on as a source of information if you are doing surveys because of the lack of uniformity in responses. One of the Insurance Department Actuaries stated there may be little enforcement unless there was a problem with the company, and then they might use the responses against the actuary.

Currently the requirements have little value as a monitoring device and this is a very foreboding issue for the industry. If actuaries are not consistent in their responses to these fairly simple and relatively unambiguous requirements, and did not take them seriously enough to answer them properly, why should we expect anything different when the more complicated valuation actuary requirements are in place?

For these requirements to be effective, we need guidelines or recommendations spelling out what level of detail is required from the actuary. If companies can answer the interrogatories in a vague manner, those companies which take an explicit approach are clearly going to be at a competitive disadvantage. Either the Academy or the NAIC should develop specific recommendations and encourage uniform enforcement. The nonguaranteed element requirements were developed to monitor industry's performance. To fulfill their intended function, they need to be taken seriously and require uniform treatment. The lack of seriousness needs to be addressed by the actuarial profession.

MR. TOZER: When the actuarial guidelines for nonguaranteed elements were under development, it was a very controversial issue within the profession. In fact, one approach was proposed and completely abandoned when it was exposed to the profession. The final actuarial guidelines adopted in December 1986 used a completely different approach. When the changes to the NAIC Convention Blank were proposed, there was strong support from both the ACLI and the various Insurance Departments. However, there was concern from both groups on the difficulty of working with the proposed changes. As a result, modifications may be required in this area in the future. For consistency, the ACLI referred questions on this subject to me as Chairman of the Academy Task Force. I expected my phone to be very active in late 1987 and early 1988. This did not happen. I have received no inquiries from any Insurance Department.

I have received some inquiries from company actuaries. One of the questions was, "Who should sign the Actuarial Opinion?" The Convention Blank, in general, is a financial statement and Actuarial Opinions are signed by the Valuation Actuary. These questions are market surveillance questions. If the NAIC had a separate market surveillance statement, this would better fit there. Consequently, the Actuarial Opinion given in this area does not need to be given by the Valuation Actuary. It could be given by the Pricing Actuary or the Marketing Actuary.

I have been asked two types of questions. The first could be stated, "How specific should the answers be?" I recommend three guideposts in answering the question. First, the actuary should provide sufficient detail to prevent any misinterpretation of the answer. Second, the answer should not be so extensive as to disclose proprietary or trade secrets. It was never intended to cause that with these types of questions. Third, the answers must be in sufficient detail to permit the insurance department to do their job. Actuaries may wish to take a look at the answers that are being prepared for Schedule M. If the company is not active in the participating market, they may want to use as a guide some of the answers prepared for Schedule M by other companies that are writing a large amount of participating insurance.

The second question concerns Interrogatory 7, which states, "Does the undersigned believe there is a substantial probability that illustrations authorized by the company to be presented on new and existing business cannot be supported by currently anticipated experience?" The question is addressed at illustrations authorized by the company. We have many agents today with personal computers who are able to make different illustrations or to change company illustrations. This question does not direct itself to what the salesmen are doing. It is directed to what the company is authorizing to be illustrated.

Second, the question asked whether the illustrations cannot be supported by currently anticipated experience. This is a different question than illustrations are supported by currently anticipated experience.

Third, the question is directed at currently anticipated experience. This does not require the actuary to make a statement on what will actually happen in the future. Instead, based on actuarial judgment, the illustrations do not have a foundation in current anticipated experience.

Fourth, the question states there is a substantial probability illustrations cannot be supported. Each actuary has to define what is a substantial probability. Nevertheless, worst case scenarios with a low probability should be ignored. Finally, the actuary should be in a position to document, if requested by the insurance department, his answer to Question 7.

In the future, actuaries will have less difficulty with this question. First, both companies and sales representatives are becoming concerned over the reliability of sales illustrations. This is seen in discussions at both the National Association of Life Underwriters (NALU) and the ACLI. The reliability of sales illustrations is also being challenged by insurance departments and the public press. Second, as interest rates have dropped, many of the sales illustrations have become more realistic.

MR. LARRY R. ROBINSON: Actuaries have the best jobs in the country, according to the *Jobs Rated Almanac*: high salary, low stress, superior work environment, security and low physical demands. Unfortunately, dealing with sales illustrations involving Nonguaranteed Elements may cause a revision in future *Almanac* rankings -- it should already be inducing stress!

Here's our dilemma: We deal with an intangible, long-term product. Our past guarantees and quasi-guarantees have been replaced with Nonguaranteed Elements. So we're selling promises with each of us outpromising the other. Little wonder that, as we say in Indiana, "the first liar doesn't have a chance."

We have been focusing on the interrogatories which provide actuarial assertions as to what we do. I want to focus on sales illustrations which also tell prospective clients and agents what we do. The trick is to have the interrogatories and illustrations in sync for two basic reasons: (1) to foster fair competition, and (2) to provide a climate for realistic consumer expectations.

I am on this panel principally as Chairman of the ACLI Subcommittee on Cost Comparisons. Much of our work has dealt with the issue of illustrating Nonguaranteed Elements. As a backdrop, I want to quote from a January 1988 *Financial Planning* article. The article is entitled "Future Shock" by Harry Lew with the sub-heading: "What will happen when a generation of insurance buyers begins comparing unrealistic illustrations with the actual performance of their policies? Industry leaders would prefer not to find out."

The article goes on to say that ". . . veterans of the insurance industry are quietly expressing concern about the way illustrations are being used in today's market." Often the numbers on the computer printout contain nonguaranteed projections on how the policy will perform in future years and tend to convince the client he is getting a better deal than he really is. Some have gone so far as to call even well-designed illustrations the industry's "great lie." Agents who continue to give much credence to nonguaranteed projections may be setting themselves up for a fall as policies fail to live up to the expectations of a whole generation of insurance customers.

Later in the article: "The controversy has already spilled into the industry press . . . Joseph M. Belth, publisher of *The Insurance Forum*, warned that aggressive advertising and unrealistic illustrations will cause 'serious problems for life insurance consumers and for the life insurance industry.' Calling 'the prominent use of gross interest rates in the marketing of interest-sensitive life insurance products' a 'deceptive sales practice,' Belth went on to question the whole concept of illustrations. . . ."

Our Subcommittee has responded in several ways. Let me share with you two of the recent, more important approaches.

First, the American Society of Chartered Life Underwriters and Chartered Financial Consultants Ethics Committee asked our Subcommittee to review and comment on a Professional Practice Guideline which was a disclosure checklist for life insurance sales material in presentations. The Society's Board of Directors approved the Guideline on April 10. I will not take the time to go over it except to indicate that it does go through the various nonguaranteed product elements and pose questions for the agent's evaluation. It also outlines some of the NAIC interrogatories on dividends and Nonguaranteed Elements. Those of your agents who are Society members are being asked to apply a higher level of professional assessment when dealing with illustrations involving Nonguaranteed Elements.

Second, at the December 1987 NAIC Meeting, the NAIC amended the Model Advertising Regulation to include a "current scale restriction." This Regulation now requires that dividends and values from Nonguaranteed Elements be based on the company's current scale.

At the request of the ACLI, the NAIC agreed to give further consideration to the current scale limitation at its June 1988 NAIC Meeting. The ACLI Board asked our Subcommittee to review a proposal which has become known as the "range approach." This approach would require that sales illustrations based on assumptions more favorable than the company's current scale be accompanied by illustrations based on correspondingly less favorable assumptions. The Board approved the proposal.

Here are some of the features of the range approach.

1. It applies to both life insurance and annuity illustrations.
2. The use of the range approach is elective, not compulsory. It would apply only when an agent illustrates amounts more favorable than those based on the company's current scale.
3. The more and less favorable assumptions are limited to interest only. Illustrated amounts may be based on interest rates up to 2% points higher than the interest rates underlying the current scale and would be accompanied by illustrations based on the current scale and interest rates that are correspondingly lower (but not less than contract guarantees).

Our hope is the range approach will help agents and policyholders view illustrations in proper perspective -- actual results may be better or worse than the current scale. This should help to improve policyholder expectations and enable agents to concentrate on the product, how the product meets needs of the client, the strength of the company and the value of the agent's services rather than the illustration.

There are some companies who are not convinced of the value of the range approach. The NALU Board currently has a prohibition against illustrations greater than current scale. Their support is vital in the political process. Other illustration issues include:

1. Definition of Current Scale -- The NAIC current position and the ACLI range approach are based on a company's current scale. What is the current scale for a company crediting new money rates which go to a portfolio basis? Should illustrations be based on the new money rate only?

2. Rate of Return -- The NAIC has asked the Academy to do research on the rate of return methodology. The idea of mandating the use of rate of return for life and annuity policies has been appealing to consumerists. The ACLI position is against rate of return. This may prove to be a "hot" topic over the next several months.

At the beginning, I indicated there are some severe problems with the sales illustrations. The results of our not successfully addressing the problems can take obvious and not-so-obvious forms. The most obvious is if we fail policyholder expectations, we may have policyholder suits. A *Wall Street Journal* article in March discussed a suit in which disappearing premiums did not disappear as promised. Less obvious is that life products may be classified as securities. Recently, the U.S. Supreme Court declined to review a lower court ruling stating fixed annuity products were securities since the policyholder bore the "investment" risk of excess interest. This is a frightening prospect and should capture our attention.

MR. PETER L. SMITH, JR.: Most states have requirements that contracts be self-supporting when they are issued. They also have the authority to request that the actuary provide the self-supporting demonstration. How do you feel about departments regularly requesting self-supporting demonstrations and also linking the illustrated assumptions with those that are utilized in the actuarial demonstration?

MR. ROBINSON: Is the question whether the products that are being sold are supportable? Certainly, the products are supportable on the basis that the Nonguaranteed Elements could go to the guarantees. The question is whether the products as they change monthly are providing the policyholder with reasonable expectation as to the value they may receive.

MR. SMITH: I think the departments have some question whether the products are always self-supporting. If the departments were to regularly require for every policy form submitted there be an actuarial demonstration of the self-supporting nature of the product and the illustration be linked to the assumptions provided in the actuarial demonstration, do you believe that would improve or hurt the current situation?

MR. ROBINSON: Seems to me that is precisely the intended result of the interrogatories.

MR. TOZER: When an actuary is doing a price demonstration to the department, one time frame and environment may be involved whereas the sales illustration may have a different time frame and environment. I am nervous about the linkage. I think it is important that both be done on a responsible basis. The results may be similar, but not necessarily the same.

MR. SMITH: It seems one possible advantage of such requirements would be that the actuary's liability might be lessened to the extent he had complied with state requirements.

MR. RODNEY C. WILTON: We cannot stop people trying to sell or design gold bricks. As actuaries, all we can do is make it so people have a better chance of knowing what they are buying. The simpler a product, the more chance the prospective policyholder has to know it is a gold brick. For instance, if it is a single premium deferred annuity, illustrated on a nonguaranteed basis at 15%, the policyholder has a good chance of knowing it may be a gold brick. What he needs is a benchmark. People have a benchmark for interest rates. In that respect, universal life is better than participating whole life since dividend scales do not have an interest rate attached to them. You can show a dividend scale that cannot be met and the buyer has no way of knowing that. A simple set of assumptions could be established and a simplistic product could be defined. If actuaries put that out, it would be a benchmark. If somebody is trying to sell something a lot better, he can say, "Which of these assumptions are you bettering? Do you have less expenses than are here? Are you going to make more interest? Are you assuming fewer are going to die, or are you trying to fool me?"

MR. TOZER: The ACLI Cost Disclosure Committee has not looked at this issue, but in the area of cost disclosure, it has tried to establish an industry benchmark and has had problems. One is a mortality standard. The mortality standard varies considerably between salary savings market and the select underwriter market. Expense standards would vary between smaller policies and larger policies. Is it more dangerous for a company to illustrate an average interest rate when it is earning a lower interest rate than someone illustrating an above average interest rate and earning that rate?

MR. WILTON: I am not talking about mandating illustrations. The company would be able to put out any illustration. But if the illustration looked too good compared to an industry vanilla product, the client would have warning.

MR. ARMAND M. DE PALO: I take an exception to the last speaker. Universal life does not have better disclosure than participating whole life. If we look at the product, the universal product has misallocated expenses. Look at an interest credited on a back end loaded product at 10% versus a participating product that is crediting 10% on a dividend fund. The NAIC has made a major effort to try to move to a Linton Yield which is vastly superior to the Interest Adjusted Cost (IAC) that we are currently using to compare products. Universal life and whole life may be compared on a reasonable basis. No index will ever be perfect, but even this index has been rejected by the Academy of Actuaries -- while it is clearly superior to the IAC.

I do agree, though with the last speaker on the other issue. There must be some norm to measure products against. There are term products in the marketplace today that are not self-supporting. A policyholder should have a right to know if he's buying a flexible product that is priced with the intention to raise the premiums.

The Society of Chartered Life Underwriter's first draft of their guidelines was a document that would allow agents to rapidly replace participating whole life business with universal life by saying, "Since you did not disclose all the individual pieces, our agent can go in and replace it." Only after the fourth draft, and much correspondence, was a reasonable document developed.

MR. BURTON D. JAY: The interrogatories represent a higher standard than mere demonstration of self-supporting. A company can have a universal life with a negative interest spread for the first year and show an illustration on the current basis with the intention of a 1.5% or 2% spread after the first year. You can demonstrate that is self-supporting. I would like some indication in the interrogatories if that is the intent of the company. It was suggested that some more guidelines are needed for the interrogatories because of the diversity of responses. The Interim Actuarial Standards Board is considering standards for actuarial opinions if it makes sense to have a standard there. The question is, "Do you feel that it is premature or would it be a good idea for the IASB to develop a fairly detailed standard of practice for answering the interrogatories and signing the statement of opinion?" When the ACLI Committee was considering the range concept, there was a 2% limit on either side of current rates. Did the board version include any limit?

MR. ROBINSON: Yes.

MR. JAY: I would be interested in your answer to the other question.

MR. ROBINSON: We talked about the possibility of providing for variances in the mortality and expense areas and decided that it would be too cumbersome and would muddy the illustration situation.

MR. TULLIS: I believe actuaries are in a position where they must sign this opinion and answer these interrogatories. I see a consumer advocate collecting and tabulating the answers with company names, in which case companies would be hurt based on their honesty and the amount of research they had done before they answered the question. If this is to be required, I think actuaries need more guidelines. I believe that the guidelines are a higher standard than just requiring supportability. We need more guidance as a profession on how to deal with them.

MR. LONNIE MILTON GRAUL: Don't you think part of the response to the interrogatories might be the choice of the lesser of two evils? An honest response might be, "The rates we are currently illustrating are not supportable because we illustrate on the portfolio rate and the portfolio rate is higher than the new money rate. If everything else stays the same, the credited rate is going to go down." If you gave that answer to the question and were in a major company and your competitor or a consumer advocate gets a hold of that, they can say, "Look, they are telling you a lie." What is the alternative? Give an incomplete answer, an incoherent answer? This seems to be the norm. An insurance regulator might think the answer was inadequate but that is three or four years from now when they do an examination.

MR. ROBINSON: You have pointed out a very real danger. Joe Belth's *Insurance Forum* discusses this in the May issue. I will repeat the names since he did. "CIGNAs unfair attack on it's mutual competitors." Then Belth shows how CIGNA used the answers to the interrogatories and said, "Here is what Connecticut Mutual said, here is what Mass Mutual said, here is what Northwestern said -- but we say . . ." We have been hearing on the committee that the interrogatories, both for the dividend supplement as well as other Non-guaranteed Elements interrogatories, are being used in a competitive situation. That has to be viewed with mixed feelings. Much the same as Joe Belth publishing the IRIS list in papers across the country. Is that a good thing or bad thing? Does it help the public or should this be information retained by the insurance department? My understanding on the interrogatories is that principally they are going to be used by the state regulators in their market conduct examination.

Joe Belth ends the article with, "I believe the series of dividend questions developed by the American Academy of Actuaries was a genuine effort to impose discipline on the actuarial profession with regard to dividend illustrations. I also believe that the responses provided by the seven mutual companies cited in the memorandum were a genuine effort to comply with the spirit of the questions." He then goes on to say that the memorandum was an unfair attack. So you've got unfair competition when you are trying to do a good job.

MR. DE PALO: Our disclosure schedule is bound in our blue statement and we will give it to other companies. It is clearly not a document suitable for policyholders but, if requested, we will send it to them. In recent years, many of the statements no longer contain this interrogatory and many companies have stated it is their policy not to make it a public document. In fact, it is a public document. It is given to the insurance department. It should be available to other companies even if it is only to compare with their statements. My statement has been summarized with other companies. As Belth's article has indicated, certain companies have answered their questions to imply they are not stating what is really happening to gain marketing advantages. Those advantages are short-lived because it is easy to turn statements which are not based on fact against them when compared to statements that are based on fact. We must make disclosures available to the informed public, not just to the regulators.

The concept of portfolio rate versus new money is always going to have differences. Those differences are going to be hard to explain to the general public, but taking away the linkage between your future scale and your current scale is a whole new world that we have not yet been ready to venture into.

MR. TOZER: Are you saying you don't think a company should be permitted to illustrate less than their current scale?

MR. DE PALO: Not at all. I think a company should illustrate what it is currently paying and should also have the right as additional information to display illustrations on a guaranteed basis and also on a lesser scale. I will give you an example of a situation in which you may even want to do it. Let's say you have an inforce block of business and it is based on the portfolio rate. The portfolio is earning 10% currently and new money, 15%. Your company, over maybe a 5- to 10-year period when cash values become substantial, will be near that 15% rate. The competition on a universal design may immediately illustrate 15% and say, "That policy should be replaced because at 15%, I out-performed their 10%." In reality, in a replacement situation, I may support having the company grade up over a reasonable period of time consistent with the length of their assets to the new money rate. Conversely, at point of sale, I do not really believe it is appropriate if the new money rate is higher than your portfolio to grade up your interest rate.

MR. ROBINSON: How do you feel about companies that price their products or develop their dividend scale using mortality improvement?

MR. DE PALO: I find that very flawed. We are a portfolio company. Our dividend scale is always based on a retrospective view with no projections ever into the future on mortality. Interest rates are never considered beyond the year we are setting the dividend scale. There are many universal contracts with a small new block of business using select mortality. That is what their current mortality is on that block of business. Even if mortality does not get worse, but moves up the selectness, the company will have to raise its mortality scales. Conversely, in the normal way of pricing participating business and establishing a dividend scale, you take selectness into account and the dividend recognizes ultimate mortality.