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ACTUARIAL OPINION ON NONGUARANTEED ELEMENTS

Moderator: WALTER N. MILLER
Panelists: JOHN K. BOOTH
SHELDON D. SUMMERS
WILLIAM T. TOZER
Recorder: ELEANOR S. HARTLEY

- Status of compliance with NAIC Annual Statement Blank requirement
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MR. WALTER N. MILLER: We're all interested in how the new annual statement questions on nonguaranteed elements are being answered. The purpose of this session is to give you some information on that and to solicit and discuss your input as to what, if anything, is going to be the impact of these new questions on companies, agents, regulators and the public.

MR. WILLIAM T. TOZER: In preparing Recommendations for Nonguaranteed Elements, the Subcommittee recognized that the use of nonguaranteed elements had grown dramatically in recent years and is still evolving. There had been little standardization in such areas as benefit design, pricing structure, marketing practices and investment philosophies. Therefore, the Subcommittee did not attempt to define and categorize certain practices or approaches as "good" or "bad" or "acceptable" or "unacceptable." Rather, the emphasis was (a) to set forth the areas of inquiry and analysis the actuary should cover in developing his advice and (b) to outline the areas where the actuary should describe the main elements of that advice and the reasons therefor.

In developing advice on nonguaranteed charges and benefits, the actuary requires a redetermination policy for the blocks of business that he is pricing. This policy, and the selection of marketing and financial objectives associated with it, is a company management decision that provides the framework within which the actuary giving advice operates.

The Subcommittee believed that sound actuarial principles require that, as part of his actuarial advice, the actuary should submit an actuarial report to the company. That report should provide recommended information to enable management to make an informed decision. The report should include a description of the framework within which the actuary's advice has been developed (including a description of the insurer's redetermination policy) and a description of the facts, methods, procedures and assumptions on which the advice was based. The report should also describe any special operating practices that could affect the repricing actions. The Recommendations also specify other items and information that the Subcommittee believed should be included in the actuarial report.

The Subcommittee discussed the issue of the company's ability to actually provide in future years the results shown in sales illustrations, where they are based upon currently determined pricing elements or some modification of current pricing. As a result, the Subcommittee asked for comments from the membership about the role of the actuary in sales illustrations. Based on these replies, the Subcommittee, through the American Academy of Actuaries, proposed and secured NAIC adoption of three sets of changes.

First, the Subcommittee secured the approval of the NAIC of modifications of the Life Cost Disclosure Model Regulation to include the statement, "If the policy has a nonguaranteed factor, [the disclosure should include] a statement indicating that the insurer reserves the right to change the nonguaranteed factor at any time and for any reason. However, if the insurer has agreed to limit this right in any way, such as, for example, if it has agreed to change a nonguaranteed factor only at certain intervals or only if there is a change in the insurer's current or anticipated experience, the statement shall indicate any such limitations on the insurer's right." In other words, the buyer should know the insurer's redetermination policy. In addition, a change was secured that required the following to be included: "If the insurer makes a material revision in the terms and conditions under which it will limit its rights to change any nonguaranteed factor, it shall no later than the first policy anniversary following the revision advise accordingly each affected policyowner."

Second, the NAIC was in the process of adopting a new Life Advertising Model Regulation. The Subcommittee worked with the NAIC to incorporate a section on nonguaranteed elements. The section requires that, "If an advertisement refers to any nonguaranteed policy element, it shall indicate that the insurer reserves the right to change any such element at any time or for any reason. However, if the insurer has agreed to limit this right in any way, such as, for example, if it has agreed to change these elements only at certain intervals or only if there is a change in the insurer's current or anticipated experience, the advertisement may indicate any such limitations on the insurer's right." Again, a potential buyer should know the company's redetermination policy. The NAIC was drawing parallels between the nonguaranteed elements and policy dividends. For this reason the Subcommittee recommended that if nonguaranteed policy elements are illustrated, they must be based on the insurer's current scale. Before adoption, the Subcommittee and the American Council of Life Insurance (ACLI) recommended that this be modified. However, the NAIC rejected the modification with the stipulation they would consider a change in the future. Last June, the ACLI recommended a noncompulsory "range concept" for two reasons. First, it permits illustrating realistic interest rates when current rates are not realistic. Second, it emphasizes to the buyer that interest rates are not fixed, but may fluctuate.

The third NAIC proposal of the Subcommittee involved the Interrogatories and Actuarial Opinion for the NAIC Convention Blank. Again, for political reasons, the Subcommittee based much of their work on the material required for Schedule M. When the changes to the NAIC Convention Blank were proposed, there was strong general support from both the ACLI and various insurance departments. However, there was concern from both groups about the difficulty of working with the proposed changes. As a result, modifications might be required in the future. The Subcommittee did not believe these interrogatories were perfect, but rather a foundation on which to build. The interrogatories have developed significant interest by the regulators, insurers, salespeople and consumers. For example, the guidelines developed by the Society of Certified Life Underwriters (CLUs) refers extensively to these interrogatories. In addition, these interrogatories have provided a base for further discussions. As a result, I feel they have made a significant contribution to our industry.

For consistency's sake, the ACLI referred questions on this subject to me as Chairman of the American Academy Task Force. Under the circumstances, I expected a very active telephone in late 1987 and early 1988. To my delight, this did not happen. I've received some inquiries from company actuaries.

These inquiries have basically been two questions. The first was a generalized question: How specific and detailed should the answers be? This is a difficult question to answer. I recommend three guideposts. First, the actuary should provide sufficient detail to prevent misinterpretation of the answers. Second, the answer should not be so extensive that it discloses proprietary information or trade secrets. Third, the answers must provide sufficient detail to meet the needs of the insurance departments. In giving guidance to company actuaries, I suggest an actuary may wish to use as a guide the answers prepared for the dividend section of Schedule M. If his company is writing little or no participating insurance, I suggest the actuary study the answers prepared by other life insurance companies that have a large amount of participating business.

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?" Each individual actuary must determine how to answer this question.

I would like to point out certain key points about the question. First, the question is addressed to "illustrations authorized by the company." We have many agents today who with the aid of personal computers are able to make different illustrations or change company illustrations. This question does not direct itself to what salesmen are doing, but to what the company is authorizing to be illustrated.

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

Fourth, the question asks whether there is a substantial probability that the illustrations cannot be supported. Each actuary has to define in his own mind what is meant by substantial probability. Nevertheless, worst case scenarios that have a low probability of occurrence should be ignored.

Finally, the actuary should be in the position to document, if requested by an insurance department, the answer to question 7.

For several reasons, I personally feel that in the future actuaries will have less difficulty in answering this question. First, both companies and sales representatives are becoming concerned over the reliability of sales illustrations currently being used. This is being seen both in discussions of the National Association of Life Underwriters (NALU) and the ACLI. The question of reliability of sales illustrations is also being addressed by insurance regulators and the public press. Second, as interest rates have dropped, many of the sales illustrations have become more realistic. These movements will encourage more realistic sales illustrations in the future and will make this question a less difficult issue.

A member of the American Academy of Actuaries asked the Actuarial Standards Board (ASB) to evaluate his answers to these interrogatories. Since these interrogatories are now NAIC requirements and not ASB standards, the ASB is reluctant to do such an evaluation. If members have questions about the actuarial Recommendations on Nonguaranteed Elements, the ASB feels this is well within their sphere of responsibility. If the Academy should become involved with answers to interrogatories, it would probably be under the Guides to Professional Conduct rather than under the Nonguaranteed Element Recommendations. However, I would like to mention that Recommendation 11 does state, "The actuary's report should describe any applicable regulatory requirements including any explicit approvals which must be given by regulatory authorities before the redetermination charges and benefits can be used. Where there are any significant interpretation questions, the report should describe these and the actuary's interpretation and conclusions."

MR. MILLER: I would like to offer two items of clarification. The first item is on the question of where the ASB and the actuarial standards of practice fit in. As Bill has correctly said, the ASB is reluctant to comment on the propriety of particular answers to the annual statement interrogatories. These interrogatories, however, were derived from a set of recommendations from Bill's committee as to the form and content of actuarial reports prepared in connection with pricing or repricing policies with nonguaranteed elements. It is these recommendations with reference to the form and content of the reports that have become actuarial standards of practice.

The second item is a footnote on Bill's statement that the American Society of CLUs has made these interrogatories an important part of some new guidelines. These guidelines were adopted, I believe, sometime around April of this year and are professional practice guidelines with respect to sales illustration disclosure packages. The American Society has a pretty good laundry list of disclosure items that agents should consider in putting together their disclosure packages and sales illustrations. As Bill mentioned, a number of these items are directly related to either the Schedule M interrogatories or the new interrogatories we're talking about this afternoon. At this time, the American Society is not requiring that all agents go through the entire checklist with respect to every illustration they supply.

MR. JOHN K. BOOTH: As background for the October 1988 Society of Actuaries panel discussion of the actuarial opinion and related questions on nonguaranteed elements which is required by the NAIC annual statement, I was asked to conduct a survey of companies' responses to the requirement. The survey request was sent to everyone who appears on the Society of Actuaries chief actuaries mailing list. The participation in the survey has been very gratifying with 222 companies responding.

One hundred and sixty-six responses indicated that their companies had policies with nonguaranteed elements; 29 indicated that their companies did not issue such policies; and 7 indicated they were not required to answer the question because their companies were either fraternals, health service corporations or alien reinsurers. Companies with nonguaranteed elements who responded represent about 28% of the 500 leading life insurance companies by premium volume. One-half of the top 50 and over 40% of the top 200 companies indicated they had policies with nonguaranteed elements. Even though the percentage with nonguaranteed elements was substantially higher for the larger companies, the responses overall seem to represent a good cross-section of the life insurance business.

HISTORICAL BACKGROUND

Before turning to the results of the survey, it would be helpful to take a look at the origin of the actuarial opinion on nonguaranteed elements and its accompanying questions. The purpose of the opinion is consumer protection and its genesis lies in the cost comparison discussions of the late 1970s, when the predominant post-issue price adjusting mechanism for the life insurance business was the determination of dividends on participating policies. At that time ledger illustrations for participating policies were usually based on the current dividend scale and most companies used the portfolio average method to allocate investment income to policies through the dividend formula. As interest rates rose, companies became more innovative and allocated investment income by the investment generation method or used other procedures to improve their ledger illustrations. Growing concerns and criticisms over the lack of discipline in dividend ledger illustrations led to the appointment of the Society of Actuaries Committee on Dividend Philosophy to address the issue.

The Society Committee and the related Academy Committee on Principles and Practices for Dividends developed recommendations which, among other things, would require an actuary to provide an opinion and information as to whether illustrated dividends are related to paid dividends in an equitable, justifiable manner, whether the portfolio average or investment generation method was used to allocate investment income, and whether there was any deviation from the contribution principle in determining dividends.

When the Committee's charge was broadened to include nonguaranteed elements as well as dividends, there had to be a significant change in focus to recognize the different nature of nonguaranteed elements. Of primary importance is the fact that nonguaranteed elements are relatively new for the industry and therefore there is no generally accepted actuarial principle for determining or redetermining nonguaranteed elements that is comparable to the contribution principle for dividends. For nonguaranteed elements contained in nonparticipating policies, there is a much looser standard of equity than for participating business where the object of dividends is to return to each policyholder a part of divisible surplus proportionate to the policy's contribution to that surplus. The redetermination of a nonguaranteed element is a pricing decision where equity among policyholders can be anything that falls within the bounds of the Unfair Trade Practices Act.

In recognition of the lack of any generally accepted actuarial principles for determining or redetermining nonguaranteed elements, the actuarial opinion and related questions are designed to require the actuary to disclose publicly what principles, practices and policies the company does use. With this information the consumer or his advisor should be better able to compare the relative attractiveness of pricing philosophies of competing companies.

Bill did mention that in the Model Life Solicitation Regulation there's a requirement to give the consumer information as to pricing philosophy. But the model has not been adopted by any state. So right now the only place a consumer can get this information is from the interrogatories and opinion filed with the annual statement.

SUMMARY OF THE RESULTS OF THE SURVEY

As might be expected, there is room for considerable latitude in the approaches used to answer various questions. Interpretation and judgment had to be used to classify and compile the wide variety of responses. In analyzing and categorizing so many responses it is quite possible that the nuances of some of the replies may have been lost. For this reason one should not view the numerical results as being mathematically precise. Rather, the summary of the results is intended to portray in a general way how actuaries are responding to the request for an opinion and answers to interrogatories on nonguaranteed elements, and in addition to point out some of the more unique responses.

DETERMINATION PROCEDURES

The NAIC Annual Statement requires for contracts that contain nonguaranteed elements a statement about a company's determination procedures that satisfies the following instruction:

> For all contracts subject to this question which were first introduced during the current year and for any other such contracts not previously reported, define the company's policy to be used in the process of determining nonguaranteed elements, with particular reference to the degree of discretion reserved for the company, together with the general methods and procedures which are expected to be used.

The responses to this request for a statement of company policy ranged from very brief summary paragraphs to several pages of description of determination and redetermination procedures broken down by policy type and sometimes by policy form. Only four responses did not contain a statement of the company policy. In describing their companies' policies, many respondents reiterated contract guarantees. The most commonly emphasized characteristic of company policy is that the company reserves complete discretion to change any of the nonguaranteed elements at almost any time beyond the next year or so. Many responses contained the phrase 2 sole discretion for added emphasis. Other policy considerations in the determination of nonguaranteed elements that were frequently mentioned were profit objectives, competition, customer expectations, interest rate spread, market yields and solvency. The language of most of the responses was so general that without access to additional information, such as the underlying actuarial report, it would not be possible to determine nonguaranteed elements for a particular company's product.

Responses frequently mentioned that the redetermination of nonguaranteed elements was not a distribution of past gains or losses. Quite a number indicated that their company's policy on redetermination of nonguaranteed elements was to maintain the profit objectives set at issue and let either good or bad experience flow through to the policyholder. Others expressed this policy somewhat differently by saying redetermination of nonguaranteed elements will adjust for differences between the anticipated experience at the time of the original pricing and the time of repricing, or that it will maintain the interest spread, or that it will result in profit margins that approximate those originally set at issue. One response said the company policy on redetermination was to maintain original profit margins but then went on to say the company reserves the right to revise its policy.

In describing their companies' redetermination policies, many responses differentiated between interest credits on the one hand and mortality and expense charges on the other. Some said there would be no change in expense charges. Many said mortality and expense charges would be changed only if there were significant changes in the underlying experience. In contrast, descriptions of the redetermination procedure for credited interest typically suggested that changes in this nonguaranteed element might be made several times during a year. Some responded that rates would be changed only in unusual circumstances on indeterminate premium policies as opposed to frequently for universal life and excess interest whole life plans. One response indicated that the formula used to derive the credited interest rate from available yields would not be changed. Another indicated that the company intended to maintain the mortality and expense charges and the interest spread for extended periods until there is a material change in the company's long-term future experience assumptions. One company noted that on a particular block of business which had been acquired from another company, the interest credited is limited to the lower of the current rate or the rate that was being credited to the block at the time it was acquired. Another mentioned that the company's reinsurer determines the nonguaranteed elements on the business that is reinsured.

A few responses tied changes in nonguaranteed elements on inforce business to changes in the corresponding nonguaranteed elements on new business. Responses from actuaries of mutual companies described redetermination processes that are closer to dividend distribution procedures. Some specifically mentioned the contribution principle. One indicated that nonguaranteed elements are determined so that the overall financial results are consistent with those of comparable participating products without nonguaranteed elements.

INTERROGATORIES

The NAIC Annual Statement requires answers to eight interrogatories concerning policies that contain nonguaranteed elements. The first three are interrelated and read as follows:

1. "Since this statement was last filed, have there been any changes in the values of nonguaranteed elements on new or existing business authorized for illustration by the company? If yes, describe the changes that were made."

2. "Since this statement was last filed, have there been any changes in the values of nonguaranteed elements actually charged or credited? If yes, describe the changes that were made."

3. "Indicate to what extent any changes described in 1 or 2 vary from the policy and/or general methods and procedures last reported for the affected contracts."

Thirty-six of the responses to the first interrogatory and 32 of the responses to the second were either "no" or "not applicable" since the 1987 NAIC Annual Statement Blank is the first to require answers to these interrogatories. Some answers stated that there was no change in the methodology even though credits and charges to individual contracts changed.

Most of the answers to the first interrogatory indicated that changes in illustrations tend to follow changes in nonguaranteed elements actually charged or credited. Several answers stated that illustrations more favorable than currently credited experience were not allowed. One answer indicated that the company expected such a standard to be followed by agents but said that it cannot be enforced. Other companies, in their illustrations, have introduced the use of different mortality or interest assumptions in the later contract years or have authorized the use of projected mortality improvements in later contract years. Some people are calling these credits in later contract years "persistency bonuses." It might be argued that they resemble the old tontines. In one case the company's authorized schedule of mortality improvement can be used in illustrations if illustrations based on its current mortality are also shown. Another company allows the insured or the agent to select projected reductions in the cost of insurance subject to company limits on annual and overall projected reductions. With respect to interest, one company prepares its illustrations in three parts based on guaranteed interest, currently credited interest and interest expected to be credited over the period illustrated. Another company bases illustrations on its current mortality charges but authorizes the use of any interest rate up to 15%.

A few answers to the first and second interrogatories included detailed tables of the interest rates credited to various types of products at different times during the year. Most responses merely indicated that interest credited has increased, decreased or changed during the year. A much smaller number of companies changed their mortality charges during the year. There were more decreases than increases in mortality charges, but about 35% of the reported changes in mortality charges were not specific as to whether the charges were increased or decreased.

Almost all of the answers to the third interrogatory indicated there were either no changes, no variation from the company's policy, or that the question was not applicable because there was no reporting on nonguaranteed elements prior to the 1987 NAIC Annual Statement Blank. Those who did indicate changes in policy described crediting higher interest to policies with either higher premiums or higher cash values, reducing mortality charges to policies with higher face amounts, assessing a specific charge for a long-range contingency fund to absorb losses from potential disintermediation, introducing projected mortality improvements in the later policy years, and changing the procedure for crediting interest on one product from a semisegregated to a portfolio approach.

The next interrogatory asks for differences between anticipated and current experience:

4. "Are the anticipated experience factors underlying any nonguaranteed elements different from current experience? If yes, describe in general terms the ways in which future experience is anticipated to differ from current experience and the nonguaranteed element factors which are affected by such anticipation."

About 55% of the answers to this interrogatory indicated that anticipated experience factors are either not different or not materially different from current experience. For those that did differ, the most commonly mentioned reason was that current expenses are higher than anticipated expenses. Many responses stated that the two would be reconciled either through growth in new business to broaden the base over which expenses are allocated or through the institution of expense control programs. A few responses indicated that anticipated expenses are higher than current, usually because of assumptions of expense inflation.

Several responses mentioned that anticipated mortality is lower than current because of assumed mortality improvements. A smaller number indicated that anticipated mortality might be higher and these frequently mentioned the AIDS epidemic. One stated that strict underwriting would hold mortality in check in spite of the AIDS epidemic.

A number of responses mentioned that anticipated interest rates would likely vary from current rates because of interest rate volatility. Some indicated that current interest credits are being subsidized and adjustments would have to be made. At least one response redefined the anticipated interest experience factor to mean the average interest rate spread. Some answered the question by saying that anticipated experience is based on current experience.

Other differences between anticipated and current experience reflect margins for adverse deviations and additional costs of increased governmental regulation.

The next two interrogatories, which relate to allocations of experience, are as follows:

5. "State whether anticipated investment income experience factors are based on (a) a portfolio average approach, (b) an investment generation approach, or (c) other. If (b) or (c), describe the general basis used, including the investment generation groupings."

6. "Describe how the company allocates anticipated experience among its various classes of business."

A little over half of the responses to question 5 indicated that the company uses a portfolio average approach to allocate investment income to various classes of business. Of the remaining responses, about 20% indicated the use of the investment generation approach, 10% the use of an "other" approach, and 20% the use of a mixture of different approaches for different products.

A large portion of the companies using the portfolio approach segment or earmark assets among different lines of business to determine the allocation of investment income. Those responses that stated a company is using an "other" approach frequently described that approach as some combination of the portfolio average and the investment generation approach with possibly some asset segmentation included as well. A number of the companies that said they use the investment generation approach apply it only for the first year or the first few years of a contract and then merge all experience together into a portfolio average allocation. The investment generation approach is used more often with single premium products or annuities and less often with products such as indeterminate premium whole life.

Answers to Interrogatory 6 were general descriptions of how expense, mortality and investment experience are allocated to various lines and types of products. Direct allocation and functional cost studies were mentioned with respect to expense allocation. Mortality costs are allocated based on both company and industry experience. Interest credits are allocated based on the approaches described in the answers to Interrogatory 5.

The answers to both Interrogatories 5 and 6, as was true of the descriptions of the determination procedures, ranged from a short paragraph to several pages of descriptive material. However, many of the descriptions contained little in the way of specific details of allocation procedures.

Interrogatory 7, which asks the actuary to opine on the likelihood that the company's illustrations cannot be supported, reads as follows:

7. "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? If yes, indicate which classes and explain."

Over 60% of the responses to this question were unqualified no's or the equivalent. More than 15% of the answers were no's but either contained a proviso that current economic conditions continue and remain stable or suggested possibilities that might turn a no into a yes. These possibilities included unanticipated variations in interest rates due to market forces, discontinuation of subsidies of the current interest crediting rates, increases in mortality due to the AIDS epidemic, small or negative company margins, inflation in unit expenses, negative gains from operations, increased federal income tax costs, inability to support illustrations when higher than current scale assumptions are used by the agent, inadequate returns for shareholders, and periodic redetermination of the current scale on which illustrations are based. The remaining responses stated that illustrations could not be supported due to interest or experience fluctuations, the AIDS epidemic, policyholder antiselection through policy options, the runoff of old business with more adequate margins, and a number of other reasons which were very similar to the provisos that qualified the no's. Since most life insurance companies are subject to the same general economic forces, it appears there is a major divergence in actuaries' interpretation of Interrogatory 7.

Departures from actuarial principles is the subject of Interrogatory 8 which reads:

8. "Describe any aspects of the determination of nonguaranteed elements not covered above that involve material departures from the actuarial principles and practices of the American Academy of Actuaries applicable to the determination of nonguaranteed elements."

Nearly all of the respondents indicated that there were no material departures from the actuarial principles and practices of the American Academy of Actuaries applicable to the determination of nonguaranteed elements. A few responses stated that there were no material departures to the best of their belief or that they did not know of any. Two responses indicated that the interrogatory was not applicable and one indicated that it had been covered in the preceding interrogatories. Another indicated that the company was clarifying its redetermination policy. One indicated that his company by management preference had not followed the procedure recommended by the Academy; the actuarial department of the company maintains files documenting the assumptions, methods and procedures for the determination of nonguaranteed elements, but there is no formal actuarial report to management.

ACTUARIAL OPINION

The NAIC Annual Statement requires the completion of an actuarial opinion with respect to the determination of nonguaranteed elements similar to the following:

> I, (name, title), am (relationship to company) and a Member of the American Academy of Actuaries. I have examined the actuarial assumptions and methods used in determining nonguaranteed elements for the individual life insurance and annuity policies of the company used for delivery in the United States. The nonguaranteed elements included are those:
>
> i. Paid, credited, charged or determined in (year of statement); and
>
> ii. Authorized by the company to be illustrated on new and existing business during (year of statement).
>
> My examination included such review of the actuarial assumptions and methods of the underlying basic records and such tests of the actuarial calculations as I considered necessary. In my opinion, the nonguaranteed elements described above have been determined in accordance with generally accepted actuarial principles and practices applicable to the determination of nonguaranteed elements, except as described above.

Although four of the responses did not include the actuarial opinion, almost all contained an opinion that followed the wording given in the instructions to the NAIC Annual Statement. There were no significant qualifications to any of the opinions.

COMMENTS ON THE SURVEY

If the purpose of the actuarial opinion and interrogatories on nonguaranteed elements is to disclose the relative differences among companies in their treatment of policyholders through the determination or redetermination of nonguaranteed elements, the results of the survey suggest some needed changes to sharpen their focus. With respect to the description of the determination procedure, there is a need to decide whether to ask for a statement of the company's philosophy or ask for a detailed numerical exposition of the company's formula for determining nonguaranteed elements. Both types of responses are contained in the survey.

Most companies change their credited and illustrated interest rates annually or more frequently. Reporting these frequent changes or commenting on them tends to mask more important changes in nonguaranteed elements or redetermination philosophy. Many actuaries have tried to address this by separating the less frequently changed nonguaranteed elements such as mortality and expenses from the credited interest rate. Interrogatories 1, 2 and 3 might produce more useful information if they were reworded to focus on changes in philosophy or changes in nonguaranteed elements other than interest rates which are subject to frequent short-term fluctuations.

There seems to be a proliferation of methods for allocating investment income to determine nonguaranteed elements. The portfolio average approach often contains segmented asset accounts, and the investment generation method frequently merges all generations into one after a very short period. Interrogatory 5 should probably be reworked to get away from labels and focus more on the substance of investment income allocation procedures.

As for the allocation of experience other than investment income, most of the answers to interrogatory 6 were textbook descriptions of allocation procedures. Perhaps this interrogatory could be incorporated into the opinion by requiring the actuary to state that generally accepted actuarial principles and practices have been followed in allocating mortality, expenses and other factors to the various product lines.

The eighth interrogatory asks the actuary to describe any aspects of the determination of nonguaranteed elements that involve material departures from the actuarial principles and practices of the American Academy of Actuaries and seems to duplicate what is contained in the opinion. Since very little revealing information was derived from interrogatory 8, it might better be covered in the actuarial opinion.

Interrogatories 4 and 7 concerning the relationship between anticipated experience factors and current experience and the likelihood that illustrations cannot be supported by anticipated experience elicited the most information. However, even the answers to these interrogatories are confused by the characteristic frequent fluctuation in interest rates. If revised to address the interest factor and the other factors separately, these interrogatories could be made much more powerful tools for gathering essential information.

USING THE ACTUARIAL OPINION AND INTERROGATORIES

Having disclosed the essential differences among companies in the determination of nonguaranteed elements, how is the consumer going to make sense out of the information? Who will determine whether the actuary who signs the opinion and answers the interrogatories has lived up to his professional responsibility? Understaffed state regulatory agencies may not have the time for in-depth reviews of the answers to the questions on nonguaranteed elements in the face of more pressing concerns such as company solvency.

Fortunately, there may be an answer to these questions in the marketplace. Agents of competing companies might have a great interest in a company's answers about its nonguaranteed elements, particularly if they can point to their own companies' pricing philosophy as being more attractive to the customer. We may be seeing not only the ledger illustration, but also the actuarial disclosure of company policy behind the nonguaranteed elements that make up the illustration become important tools in the competitive struggle between companies. Actuaries will need to discharge their professional responsibilities carefully so as not to misrepresent their companies' pricing philosophy as being more favorable to the customer than it really is. To do otherwise is to risk a call for judgment by their peers.

MR. MILLER: That was a most interesting survey, based on a relatively large data base. I have just a couple of comments. I would agree that the two most important interrogatories are the one that asks about any material differences between anticipated experience and current experience and the one that talks about ability to support the current scales. In my own mind, it's one of these, "Is the bottle half-full or half-empty?" situations. Do we become discouraged by the fact that 55% answered that current and anticipated experience were materially the same, and 60% of the answers on the critical question 7 were totally clean? Or do we say we never thought as many as 45% of the answers would indicate some material difference between current and anticipated experience, and 40% of the answers to that interrogatory 7 would be other than clean ones.

John, you mentioned the divergence in opinion between groups of actuaries as to how to answer those two questions. You may be right when you say that the divergence is in the way the actuaries interpret the questions. From a strictly subjective standpoint, I would offer that the divergence reflects the degree to which actuaries are able or not able to resist the very significant competitive pressures in the real world.

MR. SHELDON D. SUMMERS: My task is to give the regulators' view on the actuarial opinion on related questions regarding nonguaranteed elements. I contacted eight state insurance departments, including my own, to inquire as to the use of the information provided by life insurance companies.

My first question to each department was to what extent company responses and opinions were reviewed. The consensus was that little or no review was being performed. The little review some departments did consisted of checking whether domestic life companies were complying in filling out the form, and whether it was being answered correctly. One department mentioned that a particular company's responses were looked at as a result of a policyholder's complaint against the company. Reasons given for the general lack of review were lack of staff and lack of time due to other higher priorities.

I followed up the first question by asking whether any additional review in the near future was now contemplated. The consensus answer was no.

Finally, I asked whether the form had any use since so little use was being made of it. To this I received answers such as "Well, disclosure of this type of information is important and the form has potential." One department expressed concerns that companies would not take the form seriously if they knew insurance departments were not checking them very carefully.

My personal opinion is that the interrogatories and opinion on nonguaranteed elements do have some merit. The form is new and more may be done with it later on. The form forces the company to consider its policy on nonguaranteed elements. The form may also provide information to insurance department staff reviewing policyholder complaints concerning the crediting of interest or the charging of expenses and mortality costs. Consumers who own policies with nonguaranteed elements and surrender charges often have little idea as to what interest will be credited or what charges will be made. If expectations are not met, the policyholder may surrender the policy but will be assessed a charge for doing so. The form concerning nonguaranteed elements is a step forward in providing a guideline as to company intentions.

MR. MILLER: I'd like to ask one question. Given the apparent inability of insurance departments to pay much attention to these interrogatories right now, perhaps because of resource questions, do you think there's any significant possibility that future examinations might involve an audit on previous answers to these, or would that run up against the same resource stumbling block?

MR. SUMMERS: I don't know if it will be done at the triennial exams. I think possibly the staff receiving consumer complaints from policyholders who are unhappy about what a company is paying in interest or charging might review this. Actuaries who are responsible for reviewing policy forms might want to look at previous responses. In my state we do not look at dividends when we go out on examinations, so I don't think this would be any different.

MR. TOZER: When the Subcommittee worked on these questions, we said these questions are not financial questions, these are market conduct questions. The problem is that the NAIC really doesn't have a forum for market conduct questions. About the only way they can be asked is through the regular convention blank, and that is why the material was put there. If the responses are going to be audited, I think it will be when there is a market conduct audit, rather than a financial audit.

MR. DOUGLAS A. SZPER: I've spent about 12 years as a life actuary working for insurance companies, and I think it's about time there are these kinds of requirements. The statistics that Mr. Booth quoted indicate to me that some actuaries should look to their guides to professional conduct when they fill out these forms. In response to what Mr. Miller said as to whether we should look to the 60/40, or the 55/45 split in the answers as a "half-full or half-empty" type question, I think we might find out more when we see how the proportion changes next year when everyone looks back and sees what everyone else said this year.

I have one other question. What would be the implication for the actuary filling out these interrogatories if the company he worked for refused to set out a company policy with respect to the determination and redetermination of non-guaranteed elements?

MR. MILLER: My view of professional responsibility would dictate that the answer should be something like, "Company management has not developed any philosophy."

MR. TOZER: The recommendation says that the actuary is to secure a redetermination policy from company management. It is management's prerogative to set redetermination policy. But the recommendation goes on to say what should be done if the actuary is not able to secure a redetermination policy. The actuary should state what policy he assumes the company is following, and tell company management what he bases changes on.

MR. ROBERT H. DREYER: I'd like to comment on the prior question. It seems to me that our responsibility is to advise management as to the proper level of charges and as to the results of their potential courses of action, but not to make the decision for management.

MR. WILLIAM L. HEZZELWOOD: Sheldon, I'd be interested in finding out if any of the insurance departments have plans to develop anything in the nature of guidelines for answering the questions.

MR. SUMMERS: Not to my knowledge. I don't think anything is being worked on, at least not in California.

MR. BOOTH: I can make mention of a possible development in that direction. John Palmer, who heads the American Academy of Actuaries Life Insurance Committee, told me last week a subgroup has been appointed to look into the interrogatories and actuarial opinion. Perhaps they may come up with some guidelines. I assume that if they develop recommended changes, they would first go to the Actuarial Standards Board, then they would develop the recommendation which they would take back to the NAIC. I think the answers we're getting do suggest that maybe there can be some sharpening up of the questions to make them somewhat more meaningful. I would be interested if anybody would want to comment. I'd particularly like to hear your thoughts as to what to do about the fact that interest, one of the major elements in illustrations, is constantly fluctuating. What is the best way to handle that?

MR. HEZZELWOOD: I did have one other comment, but it wasn't about that. I think it was John who mentioned that the marketplace may start dealing with this issue in a more effective way than even the regulators. Just recently I learned of a situation where agents are utilizing the services of actuaries to do what they refer to as "reverse engineering" of insurance product illustrations that they encounter in the marketplace, so that they can render an opinion to their client as to the believability of the numbers. I think we may be seeing more of that. Maybe this is an area for some of the consultants to get involved in.

MR. MILLER: Illustration credibility is indeed becoming a very significant issue in upper bracket markets and with agents and marketing organizations that typically sell in those markets. I know one major mutual company has already sent their answers to the interrogatories to their agents advising their agents, "If anyone asks you how our company is answering these questions, here's what we would suggest you say." There is going to be more of that. There are going to be comparative analyses, some of which are going to be enlightening and some of which may be viewed as cheap shots.

Over the last two weeks, I've had two interesting conversations with people in other companies on a question I propounded to a few, and I'd be interested in any opinions the audience has. The question is, "What is the likelihood that uncertainty about the AIDS situation will be mentioned more and more as an uncertainty factor in company responses to these interrogatories on dividends as well as nonguaranteed elements?" I'll just give you two interesting opinions because they're quite diametrically opposed. One person said to me, "My company firmly believes that continuing secular trends of mortality improvement are going to offset whatever extra mortality we're going to get from AIDS, so we're not going to mention that; and what's more, we're going to suggest that any company that publicly admits they might have an AIDS problem may be a company that people shouldn't buy from." The other person said, "We're certainly going to put in a qualification about AIDS possibly affecting our ability to continue our scales of nonguaranteed elements, and we're going to say that any company that doesn't is irresponsible." It will be interesting to see how this all plays out.

MR. ROBERT J. POLILLI: In discussion with an actuary from another company, I reached a different conclusion from him as to what question 7 is. Essentially we were discussing the question, "If in the first year both companies had to raise the interest rate on their annuity or universal life product to meet competitive pressures, could the company support that in the long run?" We had our disagreement on two points. One, if in the long run the company wanted a certain surplus under some assumed spread between earned and credited interest and if in the first year the spread was less than desired but still positive, he felt he could say that the company could support that increased rate. And the second point of disagreement was whether even if the spread between the earned and credited interest rate had been negative, the actuary could say the company surplus could handle the difference. So I came to believe that actuaries were answering the question differently even with the same circumstances.

MR. MILLER: I would say that if you are going to take a position that the company surplus will be available to finance continuation of current crediting rates under adverse circumstances, you had better really believe that's true. It's the very difficult age-old question of professional responsibility versus responsibility to one's employer.

MR. TOZER: One comment I have is that the question concerns a sales illustration, based on the assumption of a higher interest rate for a lengthy period of time, not just in the first year or so. So that raises a real question as to whether or not that company could support that interest on a long-term basis. Sometimes you can prepare justifications for a short-term subsidy, but I don't see how you can for a long-term subsidy unless you say you're going to do it out of surplus. I personally have a severe problem with assuming use of surplus because you may not know how much business you are going to write. Surplus is not unlimited. You may be able to use it for a year or two, but then all of a sudden you're going to have enough business and you're finally going to end up, I would think, depleting the surplus. So I'm not sure that the surplus argument would hold for a long-term subsidy. It's hard to give a black and white answer. I think you have to look at the individual circumstances. There might be a circumstance where the argument could be supported, but I think you would be treading on awfully thin ice.

MR. POLILLI: When I was looking at the question concerning currently anticipated experience, I had a computer run with fifty interest rates, and I wasn't quite sure what the currently anticipated experience was. If I had assumed a level interest rate scenario with the interest rate equal to the mean of the fifty rates, I could easily support the interest rate being projected because it was a stable interest rate rather than a volatile interest rate. I found the question difficult to answer because there wasn't a single currently anticipated experience in the scenario I was dealing with.

MR. MILLER: I have no doubt there will be and should be refinements in the wording and format of these interrogatories as time goes on. The phrase *currently anticipated experience* is probably a pretty good candidate for some work. I would just throw out a question: You are the actuary of a company whose current interest scale involves one of the various forms of persistency bonuses. What is your currently anticipated lapse experience? Do you have to be able to say that your currently anticipated lapse experience involves a high enough level of lapses to enable you to support payment of those bonuses?

MR. TERRANCE T. ERICKSON: I think any time there's a nonguaranteed element you have to test on a no-lapse basis. You can perhaps assume mortality, but at least do a no-lapse test to show you can support your interest assumption. These are not tontines. The original tontines involved the death of other people for your own profit. These are win-win situations. If people keep their money with the company for a long period of time, and there's not the tremendous fluctuation in and out, then those people are entitled to a better rate of return on their investment.

Another comment is that a lot of the nonguaranteed elements are merely the avoidance of deficiency reserves. I suspect everyone is well aware of this. There is no anticipation of changing the rates. You have a low-term rate, you need to have a nonguaranteed rate, and the guaranteed rate looks suspiciously like the mortality table that you're using for reserves.

Finally, another element which someone already mentioned is that a company doesn't have control over agents. I regard that as almost humorous. There are a lot of us who deal with brokers who produce illustrations for which they set the interest rates. If they load in 32%, I'm sure their client realizes that they're being stupid. We have to have some confidence in the public. We do not assume the entire burden of protecting the public from interest assumptions that are clearly ludicrous. The public probably can't tell the difference between a 12.5% and a 10.5% illustration, but there's some point in there that becomes absolutely incredible. It's up to the consumer to have some wit to defend himself. Foolish illustrations could always be produced outside of company control by agents, even in companies who think they have the ultimate controls.

MR. TOZER: In reference to the deficiency reserve part of your question, I don't see how that really conflicts with what we're doing on nonguaranteed elements. I think it's quite a reasonable approach to say that these are the mortality rates you are using; they are not guaranteed, but if current conditions continue, you are planning on continuing to use those mortality rates. You have the right to raise them to a higher level if the experience requires it, but you have no intention of raising them unless some unforeseen development makes you raise them.

With reference to the ludicrous illustrations of interest rates, I guess they are being done, but I think there are an awful lot of agents out there right now who are explaining to the public about ludicrous interest rates. In fact, with some of the savings and loan problems in one of our larger states, they are very good at explaining, "If you're getting an interest rate above normal, one of two things is happening. Either the company is lying to you or they're investing in items that may bankrupt that company." I think the competition turns that around and hangs the company with that kind of statement. So I don't think those 32% illustrations are going to survive very long in the marketplace.

MR. ERICKSON: These illustrations are generated by the agents. The company sends out a disk that anyone with an IBM-compatible PC and a printer can use to run illustrations. An agent who's bright can alter the program. Many companies design the program so the client can specify an interest rate to be entered. The client may want to pick some arbitrary interest rate because that's what they're using as a benchmark against other carriers. In any event, the agent sets the interest rate, and even if the company intends to have a disk that keeps the agent from setting the interest rate, let me assure you the agent can set the interest rate.

MR. SUMMERS: I've seen that problem of showing high interest rates, especially in the senior citizen market. We have to take special care with the senior citizen market. I saw one universal life policy where the interest rate was projected for five years, and the interest was illustrated as increasing more rapidly. This was on an exam in which I participated with another state insurance department. Because there was some kind of misrepresentation in the interest rates, the company had to offer all policyholders with that specific policy the chance to get their money back without any surrender charges.

MR. ERICKSON: Did the company control the illustration? Did it have an illustration that had interest rates too high or did the agents?

MR. SUMMERS: I'm not sure of the answer to that, but I think it was mostly the agents.

MR. MILLER: This is a bit of a digression but still on the subject of illustrations involving very high interest rates. It's well for us to remember that not all of these illustration problems are related to the credibility of the illustrative pricing factors that go into the illustration. Some of the problems relate to the format of the illustration itself. Consider illustrations showing rate of return on death. I know that such illustrations exist. My personal opinion is that it is understandable, and perhaps essential, for such an illustration to be made up in a sophisticated client situation. One example would be a corporate-owned life insurance case being sold to a corporate client who is really interested in the flow of funds back and forth and the difference between what it puts into the policies and what it gets back. I hope the group would agree that a rate of return on death illustration is perhaps not quite as appropriate in a sale of a ten, fifteen or twenty-five thousand dollar policy to an unsophisticated prospect.

MR. JAMES A. ROBINSON: I'd like to offer two sets of comments paralleling the comments made by our previous speaker. First, when it comes to illustrations shown by an agent or broker who represents the company, I believe in the end the company is responsible for what is shown. If a customer is defrauded by an agent of a company, then that customer has recourse against the company. I think companies need to take responsibility. Audit what's being shown. Discover somehow what agents are doing. I understand the problems of control, but that does not end the responsibility.

Second, with respect to the tontine-like elements in nonguaranteed type contracts, I've seen things that bother me. Some companies issue a universal life contract that returns the cost of insurance at the tenth or some arbitrary anniversary. Other companies pay what you might call reversionary bonus interest at some specific anniversary. According to my actuarial training, this is inequitable. If a company chooses to pay a bonus at the twentieth duration, it strikes me as a large terminal dividend at the twentieth duration. I was taught that's a no-no. I believe it's wrong. I don't think we should do things as actuaries or encourage our management or sales management to do things just for competitive purposes. The real value has got to be there. I would encourage us to compete on real value. Think of the case of somebody who has to surrender his policy in the nineteenth duration for some reason, some financial emergency. Why should he be penalized because actuarial pricing formulae show the values there as being stored up for some competitive reason?

MR. MILLER: Are you saying, Jim, that you believe all termination dividend scales might be suspect or only the types of scales or bonuses that provide extra payments only at specific discrete durations?

MR. ROBINSON: I would not say all are flawed. They should reflect the asset shares as they evolve from duration to duration. I best thing for a company to do is to maximize the value given back to the customer, given profit constraints duration by duration. Don't store anything up to pay it in a latter duration just to make a super illustration or to possibly defraud a customer into buying your product.

MR. MILLER: A basic question on these interrogatories is where are they leading us and what impact are they having? On balance, is the advent of these interrogatories constructive?

MR. TOZER: The recommendations that were originally developed and the interrogatories that are built from them have a revolutionary foundation in the actuarial profession. Until these recommendations came out, we attempted in the profession to describe a method and implied that that method was the standard method. For example, in dividends we had the contribution principle. We've had other types of funding principles in pensions. We didn't say you couldn't use other methods, but if you did, you were to explain them and defend your use of them rather than the standard method.

With nonguaranteed elements we started out attempting to define a standard, our benchmark, and then said that anybody who wanted to do something different could describe that. The reaction we had from the profession was that the process was still so evolutionary that we shouldn't attempt to define a benchmark, we should use a free-form approach. What we have developed now is a free-form approach. But the foundation for that free-form approach has got to be good disclosure.

We are trying a new concept with these recommendations and interrogatories, different than the profession has ever tried before. I don't say that in support or criticism. I'd be very interested in knowing what this group thinks of what's happening. Is this a step in the right direction or the wrong direction? I'd like to know how you feel about this different approach.

MR. MILLER: Yes, the first draft tried to do what one of our committee members described as drawing a big circle of generally accepted actuarial practices with respect to this new breed of policies. The profession clearly indicated that they were not ready for that. And so as Bill indicated, the recommendations, the standard of practice and the ultimate annual statement questions are primarily related to disclosure.

Well, let me repeat the question. On balance, do you think the advent of these annual statement interrogatories has been a constructive step? A large majority say yes. There were a couple of no's here. Would any of those people like to speak to that side of the discussion?

MR. ROBERT J. CALLAHAN: I didn't vote no or yes on this question. I think there are two sides to it. I do favor disclosure to policyholders. But sometimes the policyholder may not know whether the disclosure is really appropriate.

I also feel a great deal of regulation is self-regulation. If a set of interrogatories in the annual statement calls to the attention of those who make the cost illustrations the various points which should be considered, perhaps that is a form of self-regulation which hopefully will influence the individuals to do the right thing. However, if the material in the annual statement is not reviewed by the regulators, and if the people who fill out the annual statement realize that, then it may serve no useful purpose whatsoever.

Many times the regulators are so busy with other things that they don't have the opportunity to do a study of the answers to a particular set of questions. The responsibility for disclosure goes across several bureaus within our department -- the life bureau, our policy bureau and our actuarial evaluation bureau.

We do have an inforce regulation on disclosure to policyholders and another one on the drawing board. When a regulator sees, for example, that an illustration that shows the current interest rate will increase beginning with the tenth year and continue to increase from that point on, he should see that that is stated in the policy. The amount of increase should be approximately equal to the amount of interest that was charged against the fund to amortize expenses and which is no longer needed for that purpose. Similarly, when a regulator comes across illustrations with decreasing mortality rates, he will challenge them.

But getting back to the interrogatories in the annual statement, the disclosure could be very useful on a field examination of a particular company. The answers can also be very useful for consumer advocates who may want to write articles, make summaries of those answers, and perhaps cite particular companies that may be way outside the realm of reasonableness.

MR. CHARLES P. ELAM: I think the intent of the interrogatories was good and as such represents a step forward. But my discussions with the actuaries who complete these suggest to me that there is such a wide range of interpretation from company to company of what the intent really is that perhaps the interrogatories don't really accomplish what you intended them to do. I suggest a show of hands be taken on whether or not the interrogatories would be greatly enhanced if there were firm, less ambiguous guidelines.

MR. MILLER: Let me phrase it this way. Do you think it is important to proceed quickly to the development of firmer guidelines as to how actuaries should fill out these interrogatories? About half of the audience feels it is important and four or five disagree.

MR. BOOTH: May I suggest a different question, Walt? I'd be interested to see how many feel that the interrogatories ought to be revised to make them a little easier to answer. I think there are some flaws in the interrogatories. My basic problem is that they almost force the actuary to predict where interest rates are going to go. Now we're pretty good on mortality, but I'm not sure we can predict where interest rates are going to go.

MR. MILLER: How many of you feel that an effort ought to be made to revisit the wording of the interrogatories themselves? That's a substantial majority of this group. I'm not sure we have the time to continue that discussion much more deeply now, as to how and why and what things bother people, but that's an interesting response.

MR. TOZER: I'd like to reemphasize that, as I understand it, the Life Committee of the Academy is looking at this. The chairman is John Palmer. I'm sure they would appreciate any suggestions the audience would have about improvements or additions to the questions. I strongly encourage any of you who have constructive comments to pass those on to John.

MR. THOMAS L. BAKOS: I would echo Bob Callahan's comment that if the purpose of the opinion is to provide disclosure to regulators, and if regulators are routinely ignoring the disclosure, then that purpose isn't being served. Sheldon's relatively limited survey indicated that insurance regulators aren't using the information. I wonder what enforcement authority, if any, regulators would have even if they did look at the answers to the questions -- particularly question 7.

A secondary question is that if the regulators aren't going to be making use of the information in the opinion, perhaps competing companies might make use of that information. I wonder how available the actuarial opinions are to people outside of the insurance departments. When John Booth did his survey, he wrote to the companies to ask for copies of their opinions. It seems that he might have just spent an afternoon in an insurance department office making copies. I assume he chose the way he did because it was easier.

MR. BOOTH: I didn't want to travel to 50 states.

MR. MILLER: Recalling some recent history, the committee that developed the annual statement questions on dividends, the Schedule M interrogatories, felt there should be a three-step procedure after it had first developed its recommendations to the actuary as to what should be generally accepted practice in determining dividend scales. The committee felt the first step in that procedure should be preparation of an actuarial report. The second step should be disclosure of some of the relevant pieces of information in that report in interrogatories to the annual statement. The third step the committee proposed was disclosure of some of the information in the annual statement interrogatories on sales illustrations. That third step became part of the revised Model Solicitation Regulation that, as was mentioned previously, has not yet been adopted by any states. But it got that far. I think at least a substantial number of the people on Bill Tozer's committee felt the same way about the possible ultimate direction of the disclosure that sprang from the recommendations in the actuarial report. My personal feeling is, that recognizing the resource difficulty regulators have in making a lot of analysis of this information, and despite some of the potential for misuse, the fact that the marketplace may get very involved in examining various companies' answers to these questions is an exceedingly healthy development.

MR. JAMES F. REISKYTL: Was this model disclosure actually to show the buyer what the company is doing?

MR. TOZER: Yes, however both the Model Cost Disclosure Regulation and the Advertising Solicitation Regulation had some modification made to them. And although the NAIC adopted the changes about a year ago, I don't think there have been any states that have moved on the model regulation.

MR. REISKYTL: Does this disclosure tell what the company's philosophy is on repricing?

MR. TOZER: Let me read the statement to you. "If a policy has a nonguaranteed factor, a statement [is required] indicating that the insurer reserves the right to change the nonguaranteed factor at any time and for any reason; however if the insurer has agreed to limit this right in any way, such as, for example, if it has agreed to change a nonguaranteed factor only at certain intervals or only if there is a change in the insurer's current or anticipated experience, the statement shall indicate any such limitation on the insurer's right." It goes on to say that if that policy is changed in the future, the insurer must notify the current policyowner by the next policy anniversary that there's been a change in that procedure.

MR. REISKYTL: There are a lot of types of nonguaranteed contracts, so the buyer may have no idea of what he's getting. Perhaps this disclosure ought to be part of the contract.

It comes back to what the state regulator can do if the contract simply says we're charging X and we can charge you up to Y. I don't know how they can enforce anything. Suppose the repricing has nothing to do with the company's experience. The current pricing has nothing to do with it. I don't know what the customer expectation is, and I don't know what the state regulator can do because the contract now says the policyowner has, I think, no rights. He has a right to get the current rate and a right to be charged not more than Y, but that's a very broad provision.

One wonders if the policyowners who are purchasing these contracts have any idea what their rights are and how they may be treated. I would think such a purchaser would be a bit dismayed if he found out the company doesn't even know what their philosophy is in pricing and repricing these contracts.

Perhaps this disclosure would go a long way in giving us some moral fiber for establishing some practices. Literally the actuary can't run the company. If the company doesn't want to establish a philosophy, that leaves a very difficult question. But the purchaser ought to know what the rules are, and he should know that there are no rules beyond the fact that he can't be charged more than some maximum unless the contract says something else.

With respect to the specific questions that John mentioned, I think it's a little difficult to say that you can't find some projection that might meet your current pricing. You should be able to find some projection since who knows what projection is right. Perhaps you intend to change your pricing given some events, and perhaps you do not. Perhaps you intend to treat an old customer like a new customer, and perhaps you do not. But whatever you intend to do, you ought to articulate. You have the right to say, "This is what I intend to do today, and I don't know what I intend to do tomorrow but when I get there I'll figure it out."

Could we have some reaction from the regulators' side as to whether you think customers know what they're purchasing, whether the disclosure is adequate, and more specifically, why haven't you moved on this disclosure?

MR. SUMMERS: I agree with you that if it is in the annual statement, the policyholder is not really getting the information. Hopefully, the information will be in the marketplace with the agents. We mentioned that an agent might want to get a copy of the competing company's statements, and when the agent makes a presentation, he might show that the other company doesn't have a repricing policy, or they can't really pay what they're illustrating. In California we have a bulletin regarding interest-sensitive products that says if you make a projection based on certain assumptions, you also have to make a projection based on only the guarantees found in the policy. The projection based on the guarantees has to be disclosed just as prominently.

MR. MILLER: That requirement, I think, is part of the solicitation regulations of just about every state.

MR. DAVID R. CARPENTER: I think what we're seeing here is really pretty encouraging. My first reaction to hearing Sheldon say that from a survey of eight states none of the eight states is looking at the interrogatories and none has any plans to do so, is, is it really worth all the trouble that we're going to if they're not going to look at it? My next reaction is that self-regulation, as Bob Callahan suggested, is a much better form of regulation than having our hands slapped or having to wait until we've done something awful before the regulators grab hold of questions and start rigorously reviewing everything that we're doing.

The profession has an obligation, regardless of whether the regulators step in or not, to carry out its responsibilities as professionals. We have an obligation to endeavor to make our companies stay honest and to disclose to their customers the things that they intend to do. I hope we would not think that since the regulators are not going to look at it anyway, we shouldn't put any effort into establishing a policy and adhering to the policy that we set forth. We indeed recognize our responsibilities to serve our customers, and, to the extent that we do that, regulators can concentrate on the places where there are difficulties.

MR. MILLER: I think the last comment ends this session on a particularly favorable note, with the emphasis on professional responsibility. Bill Tozer said that this is more in the nature of a revolutionary rather than an evolutionary step. We have a long way to go. It is obvious that the development of these interrogatories by the actuarial profession is not going to solve all illustration credibility problems. We don't yet know exactly how far this development will go, but there's a chance that it may have a significant impact.

About a year and a half ago a famous consumer advocate, and one with a good deal of knowledge, addressed the subject of illustration credibility in his monthly newsletter and said nobody had done anything about it, not even the actuarial profession. I called him and said that really wasn't true; the truth was that although not all the problems are solved, the only people who have really tried to do anything significant about illustration credibility questions have been the actuarial professionals by virtue of the work that has been done with respect to standards development and the various annual statement interrogatories. I think that's very important, and I couldn't agree more that, recognizing all the difficulties of balancing our professional responsibilities and our responsibilities to our employers, professional responsibility is important.

I hope we all agree that it will be constructive to work to refine this process and build on it. I think our profession can be proud of what it has done and hopefully will do further in this area.