RECORD OF SOCIETY OF ACTUARIES
1993 VOL. 19 NO. 4A

PRODUCT DESIGN/PRICING WITH BONUS FEATURES

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Recorder:	BRADLEY E. BARKS

- Advantages to policyholders
- Equity
- Disclosure
- Supportability
- Regulatory concerns

MR. BRADLEY E. BARKS: Given the high level of regulatory activity in this area, I changed the session format to be a lively discussion of the pros and cons of bonus features. Regulators are currently working on several model laws which as currently envisioned would place significant limits on these features as well as on other nonguaranteed elements.

The first to be speaking will be Barbara Lautzenheiser. She's a member of the National Association of Insurance Commissioners (NAIC) Life/Health Actuarial Task Force (LHATF) Industry Resource Group on the Standard Nonforfeiture Law for Life Insurance. She also is a past President of the Society of Actuaries, a past board member of the American Academy of Actuaries, and was one of the charter members of the Actuarial Standards Board (ASB). She's a principal at Lautzenheiser and Associates. She will be discussing the need for maximum long-term benefits, designs that maximize long-term benefits, reasons why we should focus on benefits and not cash values, and principles of equity behind bonus features.

I will follow Barbara and give a description of a practical method to define equity, and a summary of current regulatory activity.

Ted Becker will finish with a regulator's viewpoint. Ted is the chief life actuary for the Texas Department of Insurance. He has been with the department for 36 years, and he also is vice chair of the NAIC LHATF. The LHATF is the group that is currently drafting nonforfeiture laws for life insurance and annuities. They also are currently working on a new valuation law for annuities and assisting the NAIC project on life insurance disclosure. Ted will be talking about the definition of equity, the need for cash values, reasons for considering maximum limits on nonguaranteed elements, disclosure of nonguaranteed elements, and reserving practices.

MS. BARBARA J. LAUTZENHEISER: I got on an airplane a couple of months ago and someone behind me heard me talking to the person in front of me and he patted me on the shoulder and said, "Are you Barbara Lautzenheiser?" And I said, "Yes, I am." He said, "Well, I've heard you a lot but I've never seen you."

I had dinner the other night with a friend from New York who previously lived in Hartford. He had decided that he wanted to become an actor and as he was getting older, he really needed to finally make the decision to try and do it. And so he came to New York to start his acting career. Well, unfortunately, he didn't get any acting jobs so he did all sorts of things like bell hopping and waiting tables in various places. Finally, he got an opportunity to do one line in a play. So he went home with this responsibility of figuring out how to say this one line, which he had to do in three months. He practiced constantly and his wonderful line was, "Hark, I hear the cannons roar." He tried it in various ways, and he kept this up till he got exactly what he wanted. Then he practiced it for a couple more months, "Hark, I hear the cannons roar." Finally, his big night came, and he sat out on the stage, waiting for his big moment. He was very nervous listening to get his cue. All of a sudden there was this great big boom, and he cried out, "Oh, my gosh, what was that?"

NEED FOR ADEQUATE RETIREMENT INCOME

That is exactly the problem that we face with tomorrow's crisis – today's crisis is health care. Tomorrow's crisis will be adequate retirement income. We have some major problems coming down the road that few of us have paid much attention to. We need to focus on these problems to be prepared for them.

Of all the assumptions that we build into our various products, the assumption that is the most significant, particularly for retirement income (and the one that is the most predictable) is demographics. Yet we are not spending adequate time looking at demographics either to determine the human resources we will need or the financial resources, i.e., retirement benefits, we will need. We have a baby boom that is getting older. We have a baby bust following that, and we have significant impacts that will result. I suspect many of you have heard these numbers before, but I'm going to cite them because you must hear them to put the problem into perspective. As you all know, the male life expectancy is about age 80. The female life expectancy is age 84. By the year 2050, with standard projection, we're talking about a life expectancy of age 85 for a male and age 92 for a female.

When I look at my mother and mother-in-law at 81 and 86 years old, and see them looking like my grandmother did at 65, I'm not sure those year 2050 numbers are even adequate. When I start projecting out, based on my parents "apparent age," it looks like I'm going to live to 100 or 105, and I have to tell you that's scary. I'd like to retire at 55 but I can't live another 50 years on what I already have. So I will have to do something about that just like the vast majority of our nation.

Even with the numbers that are projected to 2050, we are talking about lifetimes after age 65. About a fourth of life for males and about a third of life for females will be left to live. Those are long life expectancies.

When you combine those life expectancies with the baby boomers that are beginning to move into those retirement years followed by a baby bust, the financial needs become astronomical. We see the percentages changing from what exists now – 13% of the population is 65 and over and 2% of the U.S. population is 85 and over – to what is predicted for 2050: about 23%, or almost one fourth of our entire nation will be over age 65, and 5.2%, or more than two-and-a-half times the current level, will be over age 85. I haven't yet done the numbers over age 100 but all you have to do is watch the television shows where they're talking about people living over 100 to know those percentages are increasing too. There was a TV show on the other day about twins over age 100 living in Florida.

Another statistic that most of you probably have not heard is that, in addition to this longer life span leading to far more people over age 65, a larger percentage of people will be dependent upon themselves for their own financial support. There's a projection that by the end of this millennium, we will have 30%, almost one third of our population, with no children on whom they can depend for either their financial or their physical support. That's another astronomical financial needs number. It's quite different right now. The vast majority of the elderly have most of their services provided by their children. This is not going to happen in the future. Even for the elderly with children, with 25% of the population predicted to be over age 65, and 5% over age 85, the children over age 65 are going to have to take care of themselves while they try to care for their parents. That means a lot of dependency will be on the grandchildren and the great-grandchildren.

SOCIAL PROGRAMS MEETING RETIREMENT NEEDS

So we will have an increasing number of people in need and an increasing need for money to meet their needs. We also have a social system that will be affected by those demographics as well. In 1980, the ratio of retirees to workers was 16.9 per hundred workers. By the year 2050, this ratio will almost double to 31.4 per hundred. So this is a different way for retirees to look at the deficit numbers that Senators Paul Tsongas and Warren Rudman talked about at the General Session. But you also heard Tsongas and Rudman talk about the fact that, in order to bring the deficit down, we will have to decrease those social payments. So we're not only going to have a problem of inadequate numbers of people to fund social programs (and again this is based on demographics, probably the most predictable of all our assumptions), but we're also going to probably end up with decreased income from those people. You've already seen this year that there has been an increase in income taxes. The bottom line of all this is, when you add to that the fact that the money these people will need will increase quite dramatically after age 65 (because they're going to have no one there to provide those benefits), you end up with a financial crisis. Unless we start encouraging people to save for -- and fund for -- their long life span, we will have major difficulties. The need for death protection is still there. But the need for retirement protection is growing dramatically.

PERSONAL INSURANCE MEETS THESE RETIREMENT NEEDS

What kind of a responsibility, then, does that put on us as professionals in addition to our responsibilities as part of the insurance industry? I see it as a need to do as much as we possibly can to motivate people to purchase insurance from the private sector. The social sector is not going to provide it. This is the kind of benefit that most can't afford to buy with a single premium. This is the kind of benefit that must be funded over time, and so we need to develop and look for products and ways to motivate those people to fund in advance for themselves. Motivating persons to do "what's right" is not a new concept. This has occurred with property/casualty insurance for a long time. For instance, there are discounts on premiums to encourage people to put safety equipment in hotels. That motivates people to do the right thing. The bonus systems within the life insurance contracts are similar kinds of "motivation." They motivate people to purchase the products and keep them for a very long period of time so that they can provide the pension benefits that will be needed.

BONUS FEATURES HELP CONSUMERS MEET RETIREMENT NEEDS

There are three kinds of those bonuses that are out there now in generic terms. There are lots of different twists to them. One of these generic bonuses is a persistency bonus. That bonus includes, or utilizes, the concept that, if you keep a long-term contract, you have higher interest earnings that can be received from long-term investments because there's less need for liquidity. You also, of course, end up with a longer period of time over which to amortize expenses. So the first generic bonus is one that is based upon duration.

There is a second generic bonus that is a function of the kinds of benefits that are payable. An example is an annuitization benefit (as opposed to lump-sum benefits) as an option that produces a higher benefit if elected. Probably the first person to recognize the need for that, and work very hard on it, was Bill Greenough of Teachers Insurance Annuity Association (TIAA) College Retirement Equities Fund (CREF). I spent many hours talking with Bill Greenough, and he was extremely emphatic about having no cash value at the time a person retires. He said, "If they use the cash to buy a car or buy a refrigerator or whatever, when they surrender it, (which is what we see in a lot of the age-65 benefits), they will not have the pension benefits." He was very emphatic about making sure that his company's benefits were available only as an annuitization benefit. Again from an actuarial standpoint, that decreases the disintermediation risk and, therefore, it decreases the contingency's cost and produces an additional benefit.

The third generic bonus is based on the size of the contract. With larger amounts, you end up with lower per unit expenses, and the savings can be put back into the bonus. An additional positive aspect is not just the long-term motivation of the policyholder, but also the long-term motivation of the agent. With the bonuses not payable if a person cashes out and moves to another contract, you end up discouraging any kind of replacement and encouraging a person and the agent to keep the original contract.

Unlike Bill Greenough, who felt that he needed to offer essentially one product and one product only (rather than simply different kinds of investment vehicles), I think that in the free-market system, we have to think in terms of policyholder choice. There are people who purchase life insurance contracts as an investment. They put a lot of emphasis on the cash value. They either put the emphasis on the cash value at the end or, for some of them who are a little more conservative, look at the cash values in between. But they are looking at this contract as an investment or, I don't like to say this publicly but I guess I will, as a deferral of income taxes. The life insurance contract, as an investment, puts us at some risk with the Internal Revenue Service. Nonetheless, a lot of that is done and a lot of it has been sold. As we moved to higher interest rates in the 1980s, the internal rate of return became a critical issue and we were selling contracts almost as investments.

There are other people who purchase the contract for the insurance benefits or retirement benefits or long-term-care benefits, but they are also concerned about other interim needs. So they will purchase a contract with higher cash values to meet those changing needs. For some business reasons, you also might want to have a higher cash value on your books at the front end. So there are those people who want to purchase a contract, for its insurance but with more emphasis on the cash value for flexibility or otherwise.

There also are those who buy a contract and think only in terms of the insurance benefits but who then end up surrendering it because the benefits that are payable are not adequate to keep them motivated to stay in the contract. It's a lose-lose proposition. Although these individuals purchase the contract for insurance benefits, if the cash surrender value is a major portion, or too much emphasis is put on the cash surrender value, the cost of the high cash values causes the cost of the insurance to be so great that the individual surrenders the contract. Thus their original purpose is defeated by the presence of the cash value.

This is why the bonus contracts are actually a major benefit. Instead of putting too much emphasis on the liquidity values, i.e., the cash values, it equitably pays more benefits through the bonus. This makes the contract more valuable, and it ends up encouraging policyholders to keep the contract rather than surrendering it.

The key to the motivation to buy and the ability to fill one's own needs is disclosure. Any time you are dealing with choice, you must deal with disclosure. People have to know what they are buying, what is guaranteed, what is not, and what they must do to receive the benefits. You have to communicate what the illustration is and what it is not. Too many people use the illustration for comparisons, and there is not good communication as to what it really does. The illustration is designed to show how the policy works, not to show exactly what will be paid.

NEED FOR DISCLOSURE

One of the other groups that I am on is the Insurance Industry Resource Committee on Life Insurance Disclosure which is working with the NAIC Life Disclosure Working Group. The Resource Committee has been working on a cover page to go with every illustration. That cover page specifically tells the person they have purchased either life insurance or an annuity. It specifically tells what the product is, and it specifically says that the values shown are likely to change: they will not get what this illustration says, they will get something different. It may be more, it may be less, but it will be different.

One of my personal concerns is that actuaries ended up using words that are meaningful to them. How many of your illustrations say at the bottom, "These are neither projections nor estimates?" I think they all say that because those are the words we came up with to communicate that the numbers weren't exact. If you move your paradigm to the consumer, and think about how the consumer looks at it and you tell them that this isn't a projection and this isn't an estimate, they believe exactly that. They believe that the values must be exactly right. The words that we used to say the right thing ended up saying the wrong thing.

So the Resource Committee struggled with this cover page to try to communicate what an illustration really is. We have to clarify through this disclosure (whether it's the cover page or the illustration) that the only thing that is absolutely going to be paid is the guaranteed values. We must change the expectations of the policyholder. We need to show them the kind of benefits they will get, what they have to do to receive the benefits and emphasize that some values are guaranteed and some are not.

The guaranteed values are important and we have to pay attention to them. Those cash surrender values do have a cost, both in how we provide them and at what level we provide them. Bonus features allow a company to avoid liquidity costs by encouraging policyholders to keep their contracts or use them as annuities.

The issue is no different for insurance than it is for investments. There are people who buy bonds; there are people who buy certificates of deposit (CDs); there are people who buy one-year CDs, 10-year CDs, 20-year CDs; and there are people who invest in the stock market. Disclosure is necessary. We don't forbid or ban those products. What we do, instead, is produce disclosures so that people know what they are buying.

I also think, in spite of the fact that some people purchase insurance as an investment, we must remember that we are selling an insurance contract. There is a cost to that, and the regulators have essentially recognized it. Any time a company has gone insolvent, the insurance benefits have been paid, and the annuity benefits have been paid, but the cash surrender values have usually been held back. Cash values are a secondary benefit in an insurance or annuity contract, not a primary benefit.

EQUITY INHERENT IN BONUS FEATURES

Actuaries have to remember that they are dealing with equity. Equity is what's fair, what's impartial, what gives each one its own due. Equity, however, is relative. Even if you review the law, you will find that what is equitable is something that is relative and dependent upon the specifics of the situation. I've done a lot of work on the equity versus equality concepts within the unisex issue. Each case of equity involves something that has to be tested as opposed to something that is equal. We are not talking about things that are equal. We're not talking about equal results, we're talking about equal opportunity for choice with good disclosure. Something that is equitable has a different value for each customer. A customer may feel that something is equitable if he or she is buying it for investment purposes, but may feel it is not equitable if they are buying it for a benefit purpose. We should not ban contracts. We need good disclosure on them. But we need disclosure and contracts that give each person a choice based on his or her own definition of equity.

Our responsibility then, as actuaries, is to make sure that bonuses come from good actuarial principles of equity. Are bonuses based on an amount because of lower unit costs, or are they based upon keeping a contract persistent? That way we can recover acquisition expenses faster and get an investment return that matches the asset liquidity with the liability liquidity. Are they paid through annuitization as opposed to a lump sum, much like TIAA-CREF did, so we reduce that cash-flow requirement at the point of annuitization and can equitably pay higher values from those long-term investments? Bonus payments are very equitable payments based on any one of those three criteria.

I repeat, disclosure is absolutely necessary. One of the things that has always bothered me is that we have not adequately disclosed what happens to a persisting policyholder who has a contract with early cash values. When you have early cash values that are not earned by an asset share formula, the people who persist are paying for those early cash values, but we have never disclosed that to them.

NEED FOR INNOVATION

In closing, I'm going to be the old fogy. We had a gentleman by the name of Mr. Forrest Estes at Bankers Life Nebraska. This man always kept going back into history and I find myself, after one third of a century, doing exactly the same thing. So now I am the old fogy. When you look back, what you see is an industry that, for a very long period of time, used dividends to reflect current experience, or we had totally guaranteed products with no experience adjustments or nonguaranteed elements. In the dividend formulas, we determined surplus, and then we distributed that surplus backward by the contribution principle. As computers came on line, we invented universal life contracts with direct crediting experience. Interest rates started going up in the late 1970s and early 1980s. There were people who began to use the investment-year method.

I had a really tough time when I went to my new employer in 1980 because the first responsibility I was given was to write a letter saying that the investment-year method was not appropriate. I had to go to my chief executive officer and say, "I don't happen to believe that." I had just bought a brand new house and the mortgage interest rates went up 300 basis points that week.

There was resistance to the investment-year method of allocation. Later, actuaries and the industry accepted it because it was equitable. There was resistance to universal life. Actuaries and the industry accepted it because it eliminated our disintermediation risk. Unfortunately, in doing so, the investment risk, or at least a part of it, moved to the policyholder. What we have now is a new process whereby we can match assets/liabilities so that we don't have to take that disintermediation risk or transfer the investment risk to the policyholder. The company is protected because it can make a long-term investment. The policyholder doesn't have to pay for it and, in fact, gets a bonus from it. We now have essentially the same thing we had with the investment-year method and universal life. We need to start researching and utilizing the new methodology.

Our responsibility is to determine that we can, in fact, pay a higher level of equity; that we have the availability to do that through quantification; and that we should do that because it is equitable and provides additional benefits for policyholders. We have to move away from the Henry Ford concept of, "You can have any color you want as long as it's black." We need to provide consumers with choices; we need to encourage people to fund their own retirement. So I would encourage you to move forward, to take a look at this new concept and see how you can, in fact, quantify that new layer of equity that wasn't there before but is available to you through better modeling.

MR. BARKS: I'd like to go through a method of defining equity for two-tiered products. This work was done by an associate of mine, Roger Wiard-Bauer. Then, I'd like to make a couple of general comments about equity, and finally summarize current regulatory activity.

OBJECTIVE MEASUREMENT OF EQUITY OF TWO-TIERED ANNUITY PRODUCTS

As Barbara mentioned, there are various circumstances that give rise to equitable differences in benefit levels: contract size; the length of time from investment to liquidation; the level of immunization between benefit flows and asset cash flows, i.e., C-3 risk; and the ability to recover acquisition costs. Two-tiered annuities are a clear example of the differences in benefits that exist because of differences in the relative length of time before electing and receiving benefits. The concept presented in the handout is essentially that the yield curve defines the expectation of the relative value in the financial market. Hence, the consumer's expectation of rates of return given the length of investments should be consistent with the yield curve.

METHODOLOGY

Since policyholders who elect the benefit at different durations are investing for different periods of time, they should expect different rates of return. In the case of a two-tiered annuity, a policyholder who elects a cash-value benefit at, say, duration 5, and a policyholder who elects a ten-year annuity payout benefit at duration 5 have invested for different periods. The two-tiered structure recognizes these differences. This analysis computes the cash value based on the single premium and on the spot rate for the number of years from issue to the benefit election date. Then the amount of each benefit payment is computed in a similar fashion. The present value of the annuity benefit (the account value) is computed using a discount rate, and this account value is compared to the cash value. This ratio is the equitable tier differential for a two-tiered annuity.

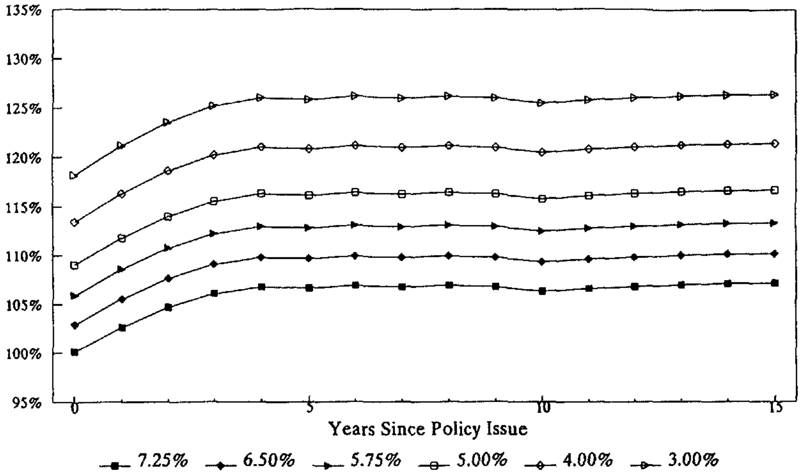
RESULTS

Chart 1 shows that, given a hypothetical yield curve, the equitable ratio of account value to cash value exceeds 20% at guaranteed purchase rates and is at least 110% at current payout rates. This simply reflects the differential in the market between long-term and short-term investments. The different lines relate to the different payout rate levels. This would suggest that to achieve equity on a guaranteed basis, products should guarantee to calculate ten-year annuitization benefits at 120% of the cash value. In Chart 2, the bottom line is a traditional design, and the top line is a two-tiered design. The differential between the two lines is about 80% throughout the duration of the contract.

Chart 3 shows that even higher ratios are suggested by average yield curves from 1978-92. The differentials were calculated for each yield curve on a quarterly basis for 1978-92, and then averages of the differentials were computed. You can see that the higher ratios are also justified for longer durations of payout. For current payout rates, a 20% differential between account value and cash value is equitable by the tenth year of the contract. This result, shown on Chart 4, combines the effect of the yield curve with the reduced disintermediation risk of annuitization benefits. The payout rates close to the issue date are lower because of the yield curve, but by the tenth duration, the equitable payout rate for a 20% tier differential exceeds 6%.

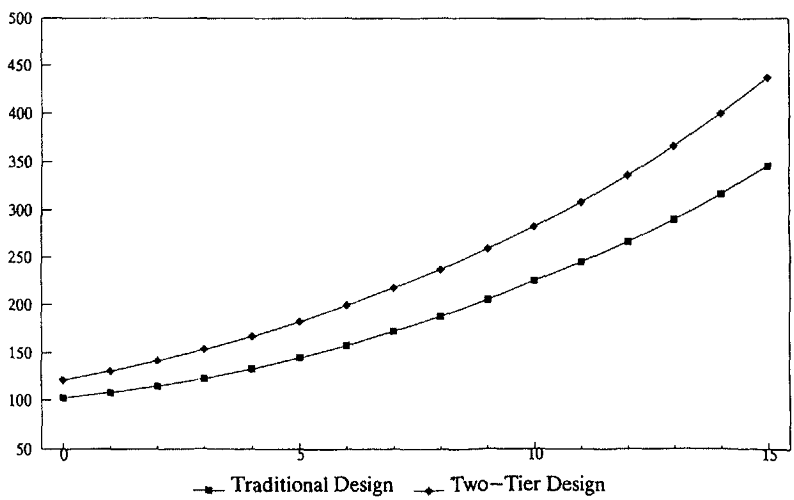
Of course, there are many other ways to define equity. The most common is a comparison of the asset shares to the benefit amounts. An asset share methodology for defining equity parallel to the yield curve methodology I just presented could be developed.

CHART 1
Ratio of Account Value to Cash Value for Various Pay Out Interest Rates



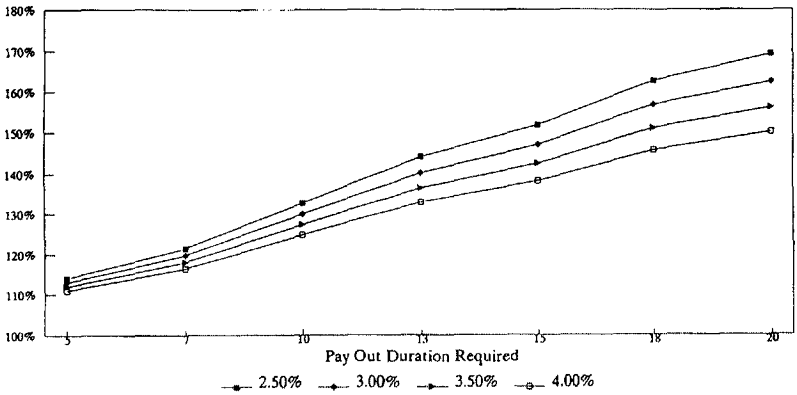
Note: For each set of an account value and a payout interest rate, the resulting annual payment is exactly the equitable payment level and all sets produce exactly the same equitable annual payment for any specific year from issue.

CHART 2
Guaranteed Annual Payments



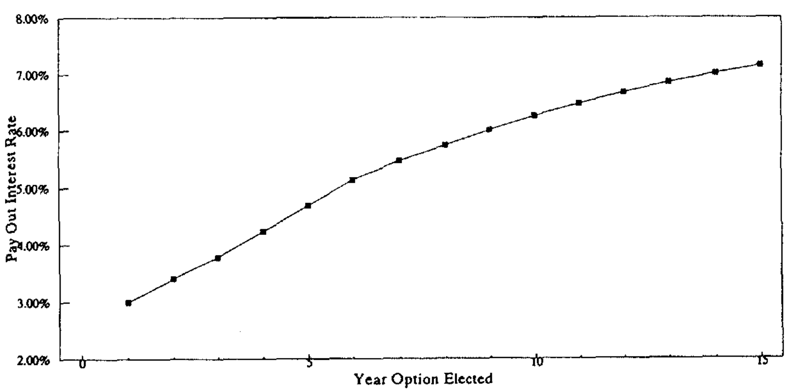
Note: The two-tier product design reproduces exactly the equitable annual payment level. The traditional product design provides a weaker annuitization guarantee and returns to the consumer only about 80% of the equitable payment level.

CHART 3
Average Ratio of Account Value to Cash Value for Various Pay Out Interest Rates Based on Treasury Yield Curves from 1978 Quarter 1 to 1992 Quarter 1.



Note: The longer the required payout duration, the higher the ratio of the account value to the cash value. The lower the guaranteed payout interest rate, the higher the ratio. Values shown are the averages of the maximum ratio for 57 different treasury yield curves, based on values at the end of the quarter for the period 1978, first quarter, to 1992, first quarter.

CHART 4
Equitable Levels of Current Pay Out Interest Rates for a Product with an Account Value 20% Higher than the Cash Value



Note: A ten-year annuity-certain with a 3% guaranteed rate is the settlement form used in the analysis. In year one, the guaranteed rate combined with the high account value results in equitable annual payments being provided. For later years, the higher investment earnings of the longer duration assets allow current payout rates to be achieved by year ten. The consumer benefits from stronger guaranteed values and, ultimately, receives even higher annuity payments based on the contribution principle.

By designing an investment portfolio that matches the benefit cash flows, yields on the investments could then be associated with specific benefits. This would produce differentials between lump-sum cash benefit amounts and annuity benefit amounts similar to those in the yield curve methodology. However, this method would be much more cumbersome and complex than the yield curve method that was presented.

EXAMPLE OF THE INEQUITY TOLERATED IN TRADITIONAL PRODUCTS

I also prepared an example of comparative equity between earlier and later duration cash values on a hypothetical interest-sensitive whole-life contract to give a reference point to the magnitude of the differential in the equity that exists in current products without bonus features (Table 1). This helps give the entire discussion some perspective. This is a contract that uses net level cash values. In other words, it has no surrender charges. It also has commissions and issue expenses of approximately 75% of premium. My company doesn't sell this particular contract, but you can find similar contracts in the market. As you can see, there is a large inequity in favor of those who surrender during the first seven years. Up to 270% of the asset share is paid to policyholders who surrender in those years. This inequity must be paid by those who persist. The point is that we may be arguing over 10-20% on certain bonus features while many products that we will continue to allow under proposed laws can be much more inequitable, although in the opposite way. Obviously, bonus features are criticized because they don't pay enough to policyholders who terminate early. This product could be criticized because it pays to much to policyholders who terminate early.

STANDARD NONFORFEITURE LAW (SNFL) FOR LIFE INSURANCE

I want to summarize some of the current regulatory activity that could affect bonus features. The LHATF just met in San Diego. The SNFL for life insurance is being rewritten. I believe the deadline for adoption is in June 1994, so it will probably be going out of the LHATF to the A committee in the first quarter of 1994. I'd first like to note that the rules as currently proposed split the treatment of fund-based products from traditional products. It also has separate sections on single-premium products. The following applies mostly to the fund-based products. At the moment, there's a maximum current credited interest rate limit. That limit is proposed to be the greatest of the company's portfolio yield excluding capital gains, the company's new money rate, and I believe it's Moody's corporate yield for the prior December but at least three months prior. There are various limitations on current cash values, and I believe there's also a smoothness test, although I think there's some work that needs to be done on that. I understand that linear grading of cash values would fail under the current smoothness test.

SNFL FOR ANNUITIES

The Standard Nonforfeiture Law for Annuities has a similar target deadline. I believe it is March 1994 so it has an even shorter deadline. It imposes a limit of 10% of premium on the first year load or surrender charges and limits the ratio of the current account value to the cash value to no more than 110%.

TABLE 1
Whole Life Contract – No Surrender Charge

Duration	Cash Surrender Value	Asset Share	Ratio of Available Benefit to Asset Share
1	11.99	4.33	276.83%
2	16.36	10.95	149.38
3	20.46	16.37	124.96
4	23.83	20.77	114.76
5	26.71	24.52	108.93
6	29.22	27.94	104.59
7	31.56	31.14	101.36
8	33.87	34.29	98.79
9	36.17	37.43	96.64
10	38.43	40.55	94.76
11	40.70	43.73	93.09
12	42.92	46.89	91.53
13	45.12	50.13	90.01
14	47.33	53.47	88.51
15	51.65	57.43	89.93
16	54.04	60.90	88.75
17	56.35	64.35	87.57
18	58.58	67.81	86.39
19	60.73	71.28	85.20
20	62.79	74.75	84.00
21	64.78	78.25	82.79
22	66.69	81.77	81.57
23	68.53	85.31	80.33
24	70.29	88.89	79.07
25	71.93	92.49	77.77
26	73.45	96.09	76.44
27	74.82	99.70	75.05
28	76.04	103.31	73.60
29	77.09	106.92	72.10
30	77.97	110.54	70.54
31	78.67	114.15	68.91
32	79.16	117.76	67.22
33	79.45	121.37	65.46
34	79.51	124.97	63.62
35	79.34	128.58	61.71
36	78.93	132.18	59.71
37	78.25	135.77	57.63
38	77.29	139.34	55.47
39	76.03	142.89	53.21
40	74.47	146.43	50.85
41	72.59	149.97	48.41
42	70.35	153.46	45.84
43	67.71	156.90	43.15
44	64.65	160.30	40.33
45	61.22	163.69	37.40

The account value is defined as the largest value used to compute any benefit except the death benefit. It would require that current surrender charges grade off no more quickly than 2% a year, and there are, as in the life law, different types of annuity products in the proposed Annuity Standard Nonforfeiture Law.The two other types are a limited surrender benefit annuity where cash values need only be available every three to ten years depending upon a guarantee period. So you'd match the guarantee period to the time when cash values have to be available. Also, there's a provision for a no cash value annuity where no loans or lump-sum settlements would be allowed.

DISCLOSURE LAW FOR LIFE INSURANCE

The third significant development is the disclosure law for life insurance. Again, the deadline we're looking at is probably June 1994. There's no current draft of the law, but there are many proposals, and I guess a lot of the proposals are being driven by Senator Metzenbaum. So you can take that into account when you're listening to this.

The draft law would require disclosure of the requirements that must be met to receive benefits in the illustrations, and it would highlight vanishing-premium situations. There are various other proposals for specific types of benefits. We would identify noncash benefits as "not available for lump sum" in illustrations; we would require a cover page that Barbara mentioned earlier that presents standard information about each policy; we would require a cover page to be signed by the agent and the applicant and submitted with the application; and we would enforce some sort of supportability standard. At this point, the definition of supportability really hasn't been developed yet. My recollection is that the supportability standard talked about being supportable for at least two or three years from the date of the illustration.

From there, we start getting into the Metzenbaum-type suggestions to have all illustrations prepared using a standard set of formats. Essentially what that would mean is that every illustration would look the same, or maybe there would be a half dozen allowable formats, and all illustrations would have to fall into that format, use the same wording, the same format or the same numbers, etc. All illustrations would use a standard set of assumptions. Another ancillary suggestion to that is to provide only guaranteed values in illustrations. These ideas get their impetus from mutual fund prospectuses where essentially only past experiences but no projections can be shown.

CONCLUSION

Clearly, many of these changes are progressive; however, many of these changes are designed to decrease the choices that policyholders will have. Because the consumer's needs and values vary considerably, many consumers may no longer be able to purchase the benefits they desire. They may not be able to trade benefit flexibility for maximum benefits as bonus features allow.

MR. TED BECKER: As Brad told you, I'm a regulatory actuary. As a regulatory actuary, I'm concerned about policyholder treatment, and I'm also concerned about company solvency and maintaining a healthy industry to better serve the public in my state of Texas. Hopefully, I can also help accomplish these same goals to some extent in other states through my activity with the NAIC. I'm a member of this same

NAIC Life and Health Actuarial Task Force that has been mentioned several times. I'm also active in a special Nonforfeiture Law Working Group that originally had both regulatory and industry members but has now been separated into two parts. One part consists of the regulatory actuaries who have the ultimate responsibility for developing a proposed Second Standard Nonforfeiture Law for Life Insurance, to replace the existing law for life insurance policies sold after a certain date in the future. However, the other part is a separate group that includes Barbara and other eminent people in the actuarial field. Through this second part, companies and the industry in general are able to furnish us with their thoughts.

My presentation will have two sections. First, I plan to talk on equity issues as they relate to nonforfeiture benefits and nonguaranteed benefits. After that I want to make some additional comments dealing more specifically with bonuses.

DEFINITION OF EQUITY

Let's get started with the definition of equity. The dictionary definition would be "fairness" or "justice." One of the other speakers mentioned impartiality, which would also fit into equity. We usually start off thinking about equity on surrender of contracts; and, in theory, that would be the largest payment that would leave the company and the remaining policyholders in essentially the same position as if the surrender had not occurred. We need a practical alternative because we can't calculate that number exactly. Some of the ideas that have been discussed start out with the reserve, or the reserve less a surrender charge. More refined methods would involve the asset share, and we're now giving detailed consideration to modified guaranteed contracts and to contracts that would adjust to the interest rate environment. There is a whole section on those types of contracts in the proposed new Second Standard Nonforfeiture Law for Life Insurance, which our group of regulatory actuaries is developing.

Now I want to talk about contracts with guaranteed payments. I believe that most regulators feel that any guaranteed payments should be consistent with the contract wording, and consistent with the participating or nonparticipating nature of the contract. The contribution principle could apply in any event; but, in general, a participating contract would look back and a nonparticipating contract would look ahead to the near future. There should be an avoidance of the tontine principle. It's been a long standing requirement that dividends be distributed annually, or at least that an annual accounting be made.

I believe that nonguaranteed payments (at least those that are illustrated) should also be distributed at least annually. Perhaps they should be distributed more frequently in some cases.

REASONS FOR CONCERN ABOUT CASH VALUES

Here are some reasons why regulators are concerned about termination benefits such as cash values. One reason is that the amount paid for premiums typically represents a very large transaction on the part of the policyholder. It represents a lot of his or her money. Taking a complete loss on a life insurance policy or annuity contract is quite different from getting a bad restaurant meal or a bad haircut or a bad shoe shine. In the case of these insurance contracts, the policyholder has probably put a good bit of his or her resources and money into that contract; and he or she should have some reasonable amount built up in the contract if there have been prepayments or prefunded amounts.

Another reason is that the policyholder's needs can change. After all, he or she is unable to predict the future. There could now be an inability to continue the premiums required by the contract. That could easily happen if the policyholder lost his or her job. Also, a life insurance contract might have been purchased primarily to provide an education for one of the policyholder's children and that child might decide that he does not want a college education. So, that type of need can't be fully predicted.

Still another reason is that the contract may not live up to the policyholder's expectations. The policyholder has no protection at all against a change in the company's ownership or a change in its philosophy. A company that sold a lot of universal life insurance and annuities could change its philosophy and decide to move over into the term insurance market. Having moved into that market, this company might not take much interest in its existing universal life policies or annuity contracts because it wasn't selling any more of them. Also, the illustrations provided at the time of sale might have been overly optimistic. Barbara and Brad mentioned some of these same issues. The Life and Health Actuarial Task Force is trying to help by keeping illustrations within reasonable boundaries in the future, so as to control that problem somewhat. The point would be that most contracts are not purchased by the policyholder with the intention that he or she is soon going to lapse that contract. The punishment for requesting the cash value should not be unduly severe, nor should it be inflicted merely for not having been loyal to the company. In some cases, the policyholder would even suffer tax consequences upon surrender in addition to losing part of the premiums paid in.

Here are some reasons cash values may be more important than insurance benefits in certain cases. The contract may have been purchased as an investment; this is frequently the case with annuities. Also, cash value considerations may have been material in the policyholder's choice of company and plan of insurance. The prospective policyholder may have had a fairly good idea of what kind of contract he or she wanted. He or she may have gotten illustrations from two or three companies and then chosen the one that had the most favorable of those illustrations. Finally, some contracts have provisions that might encourage surrender (at least in certain instances). An example of that would be a bailout provision in an annuity. Another somewhat similar example would be an annuity that waives surrender charges if the annuitant becomes disabled or is hospitalized for a certain period of time.

REASONS FOR MAXIMUM AND MINIMUM NONFORFEITURE BENEFITS

The new draft Second Standard Nonforfeiture Law for Life Insurance is under discussion, and it has been proposed to set maximum limits on nonguaranteed benefits as well as minimum limits on guaranteed benefits. I want to touch briefly on some of the reasons for that. There are concerns among regulators that providing non-guaranteed benefits in some circumstances, but not in others, is a form of forfeiture and, at the least, such forfeiture should be regulated by the law. There also are concerns about how nonguaranteed benefits are being used, and concerns that contracts are being sold on the basis that flexibility is an advantage. But in some of these same "flexible" policies, the policyholder is penalized rather heavily if the policy is not used the way the company wants it used. Typically, the company would want the policyholder to put more money into the contract, to avoid taking out policy loans, and to keep the contract in force for a number of years.

Here are some reasons for concern about disclosure of values beyond guarantees. I'm going to talk about nonguarantees in more detail in a minute, but I would like to make the point that there should be at least some basis for any illustration. Any illustrated nonguaranteed payment should not violate the model Unfair Trade Practices Act. In the Texas Insurance Code that's Article 21.21, Section 4. It is my impression that most other states have very similar legislation, but not all states necessarily interpret this legislation the same way. Another matter that has been brought up is a limitation on the number of years that nonguarantees can be shown in illustrations. So far, I don't know if that has been discussed at the NAIC level. The Texas Department of Insurance does not have a definite position as yet, either at the staff level or through any of our Board's rules or regulations. However, it is obvious that the effect of compounding nonguaranteed benefits over a long period of time can be substantial.

Let's move to a more detailed consideration of bonuses. A dictionary definition of a bonuses would be something given in addition to what is usual or strictly due. In our case, we'll be considering both guaranteed and nonguaranteed types of bonuses. First, I want to express the current position of the staff at the Texas Department of Insurance. With respect to guaranteed bonuses, the current position would be that these can be illustrated to prospective purchasers and such guaranteed bonuses would affect reserve calculations under the Standard Valuation Law and nonforfeiture value calculations under the Standard Nonforfeiture Law. These guaranteed benefits must be included in the present value of future guaranteed benefits under those laws. The calculations would be made under the most conservative assumptions possible. In other words, if a guaranteed bonus could mature upon the completion of a certain number of premium payments, we would assume that such a bonus would mature at the very earliest time possible under the terms of the contract.

Now nonguaranteed bonuses are a different matter, and I want to go over those in some detail.

We do have a current "staff position" on nonguaranteed bonuses in Texas. When I say "staff position," I mean what we're currently enforcing in Texas. I also am indicating that our board does not have a definite written rule or regulation up to this point. (We have a State Board of Insurance that has rulemaking authority in our state, although in the future, rules are expected to be promulgated by our commissioner.) I have already mentioned the Model Unfair Trade Practices Act, which permits nonguaranteed bonuses in a specific type of situation. That act states that bonuses can be paid out of accumulations from surplus on nonparticipating contracts, subject to certain conditions. However, the staff does not believe that this statutory reference constitutes authority to illustrate such payments to prospective policyholders. The staff's interpretation of that reference in the statute is to relate it to the type of situation where a contract is placed in force and then starts generating unexpected windfall profits for the company. The staff believes that this reference would permit the company to share those profits with the policyholders after they materialize. In the absence of that provision, the stockholders of the company could claim that those profits belonged to them as stockholders and should ultimately accrue to them. Under that alternative interpretation, company management could not share such profits with policyholders.

In general, nonparticipating contracts should not distribute past gains or attempt to recoup past losses. At least that's the current position of the staff at the Texas Department of Insurance. This position is consistent with a definite rule that has been promulgated by our board on "indeterminate premium policies." (We have a special longer name for those policies in our Texas regulation, but it's the same type of product.) As an aside, I might mention that the fixed-premium universal life insurance regulation issued by the state of Washington takes a similar position: that nonparticipating contracts should not distribute past gains or attempt to recoup past losses. I understand that Washington is considering a similar provision in a proposed flexible-premium universal life insurance regulation. They were considering this the last time I talked to a representative of that department on the telephone. I would call your attention to the fact that Actuarial Standard of Practice (ASOP) No. 1 does not seem to take this strict a position; and it can be argued that standard of practice is adaptable not only to the Texas "staff position" and to the Washington regulation, but possibly to the positions of other states that might have different interpretations. I would suggest that any company considering nonguaranteed bonuses in the future should check with the states in which it is licensed to make sure that the program it wishes to use is satisfactory and considered legal by those states. Now, I do believe that there are some other states that would allow nonguaranteed bonuses to be illustrated. If such nonguaranteed bonuses were illustrated to prospective policyholders in those states, it would be appropriate for companies to set up a reserve for the future distribution of such bonuses to people in those states. It would be better to check with a state that allows nonguaranteed bonuses to be illustrated. That state could give guidance as to what kind of reserve it requires and whether lapses can be taken into account in setting up such a reserve.

CONCLUSION

I wish to close by touching briefly on the three major projects of our NAIC Life and Health Actuarial Task Force. One major project is the development of a new Second Standard Nonforfeiture Law for Life Insurance which would apply to new life insurance policies issued after a certain specific date. This may involve the development of a companion model regulation on enhancements. (Such a model regulation would presumably take a position on bonuses.) So we may have a more uniform treatment by the states in the future when we have this revised model law and when we have developed a model regulation on enhancements.

Another major project is the development of a new Standard Nonforfeiture Law for Annuities, and I think Brad covered it quite well. The third major project is the study of illustrations of life insurance contracts. That project will involve a special Life Disclosure Working Group chaired by Robert Wright of the Virginia Bureau of Insurance, which has the primary responsibility for the study. Our Actuarial Task Force is assisting on this project and attempting to give actuarial advice when appropriate. A model NAIC regulation on illustrations is expected to be developed, and hopefully this will also lead to more uniformity among the states. This third project will involve both life insurance policies and annuity contracts, but the initial efforts have been concentrated on life insurance policies.

MR. JAMES R. THOMPSON: Some literature has come across my desk from agencies in regard to equity of bonuses. It says that they'll give a bonus interest rate if a person rolls money over. It usually says it in a little footnote "in 20 years or so." So I can see the equity on longevity, but can anyone explain what sort of actuarial equity results from the function of rolling over from another company?

MS. LAUTZENHEISER: I don't think we have one.

MR. BARKS: Anybody have an answer for that? I don't have one.

MR. THOMPSON: I've heard one explanation of the way you do that. The agent agrees to forego commissions that are equal to the same percentage that the bonus amounts to. So I guess if I could use the "R" word, it's a form of rebating.

FROM THE FLOOR: I have a question specifically for Ted because he provided some insight on it. There's a lot of discussion about equitable bonuses and fair treatment to policyholders, and I think we're all in agreement that it is important. Bonuses that meet that need and encourage the type of policyholder actions that Barbara referred to, where they give up some flexibility in return for the opportunity to get other benefits down the road, are a good idea. The things that I have a problem with are the bonuses that are pie-in-the-sky. If it seems too good to be true, it probably is. Those are the ones that nobody specifically addressed in these discussions. To my knowledge, the only state that has any type of specific regulation with a definition of a bonus is New Jersey. It basically says, if it looks like a duck and quacks, it probably is a duck. In New Jersey, they have to do some type of illustration or demonstration that shows the cash values compared to the asset shares make some sense. To the panelists' knowledge, is there any movement in other states to effectuate that type of demonstration requirement?

MR. BECKER: I don't know of anything except the three projects at the NAIC Actuarial Task Force level.

MR. BARKS: I believe New Jersey, at one point, had a ban on bonuses. So if it was a bonus, they said you couldn't do it. I think what you're talking about is the supportability issue where there is a product that doesn't appear to be supportable. It can take any number of forms. It could be a particular bonus, it could be a very high initial interest rate, whatever it may be. It appears that it's not supportable in the long term. I don't have any specific information on that, but I think the disclosure group is trying to develop a definition for supportability and to include some information in the disclosure.

The other thing that probably wasn't covered very well was doing sensitivity analyses on illustrations. It would be very difficult to do this. I think the task force is focusing mostly on interest rates, but theoretically you could do it for any assumption. I think it gets very complex from the policyholder's point of view if you do it on too many assumptions. So theoretically, you could show what the values would be at 100 basis points less, or assume a specific event happened in the term structure of interest rates and then project what would happen with the benefits. There was a recent letter from Transamerica that discussed the problems of applying something like that to portfolio-based crediting versus investment-year crediting and projecting the effect it would have on the company and the product. I think that's what you're getting at: a new disclosure area addressing that issue.

MS. LAUTZENHEISER: I'm going to give a couple more old fogy comments. One has to do with the investment-year method. I believe when the Equitable started that method in the late 1970s there was a lot of conversation about illustrations and disclosure and the fact that the Equitable might be illustrating things that were not appropriate. Again, that was based on a lack of knowledge. As we all began to realize that interest rates were going up and the investment-year method probably made some sense, most of us moved in that direction. Similarly, when I was with the Bankers of Nebraska before going to the Phoenix Mutual, every one of my agents kept saying either, "The Phoenix Mutual can't possibly be doing what is right," or "Why can't we have those low net costs?" I teased them as I left and I said, "Well, I can't do that at the Bankers of Nebraska because of its expenses, so that's why I'm moving." There were many people who accused the Phoenix Mutual of doing things that were not appropriate. I will tell you that Bob Jackson had the foresight 20 years earlier to cut all of his expenses and to move to the nonsmoker tables. He did so 15 years before the rest of the industry, with the exception of State Mutual. Almost all of Phoenix Mutual's brokers had 100% persistency because there were virtually no other nonsmoker contracts available. Phoenix Mutual had real numbers. So it was very easy for people to say the numbers weren't real, but when I transferred to Phoenix Mutual, I found out the numbers were real.

That's why I think it is imperative that we do two things. First, we must begin to investigate the available research to see whether or not it does make sense and if the numbers are real. Second, at the ASB level, we need to promote the contribution principle for nonguaranteed elements in Actuarial Standard of Practice No. 1. In spite of the fact that a lot of companies would like to continue to do exactly what they want, we owe a level of equity to the consumer. We can do that in nonguaranteed elements, just as we can in dividends, by putting the contribution principle in ASOP No. 15 (where we address the dividends) as well as in ASOP No. 1 with the nonguaranteed elements.

MR. WILLIAM C. KOENIG: This probably falls in the category of a statement for the record more than a question, but I will get to a question later on. First, I am pleased to hear that Barbara Lautzenheiser is urging the ASB to extend the discipline of the contribution method to all nonguaranteed elements. This would be a great step in the right direction.

Despite Ms. Lautzenheiser's excellent discussion of the need for responsible retirement planning, her arguments have always seemed to me to be more a condemnation of the sorts of products that were discussed here than an endorsement.

These bonuses motivate people to buy products in the same way that a big jackpot motivates people to buy lottery tickets. It works great for the one winner in ten million, but not so well for the high proportion of losers.

I've seen one of these products discussed in an industry publication like this: The declared 7% crediting rate resulted in a 13% effective yield over the long term because of low expenses. No actuarial theory I know can reduce expenses so that

7% becomes 13% unless the early terminators are ripped off. So, if there are no early terminators, there are no forfeitures to fund the "bonuses" and the scheme is exposed for what it is: a sad revisiting of the tontine pricing that brought disgrace to the industry in the early years of this century.

Disclosure is important. If nothing else, companies should be required to admit whenever they can't afford to pay their bonuses if everyone does what the company says it wants -- stick around to collect. Better yet, as Mr. Becker suggested, all companies that offer participation rights to their policyowners, or quasiparticipation in the case of stock companies, should be required to have an *annual* distribution of surplus, as is the case for mutual companies operating in New York.

So, my question is, how could I in good conscience advise my wife to buy such a product when the only way it can work for her is if it fails for other deserving, long-lived women; and it probably has to fail for four or five women for every one it works for? (And, of course, if she needs her money early, perhaps through no fault of her own, she pays a terribly onerous price.)

MS. LAUTZENHEISER: The only comment I can make to you is that I understand what you are saying, and I think disclosure is the absolute number one criterion, as I said earlier. I have long thought, both as a female and as someone who believes in choice, that I probably come close to being a libertarian because I want the opportunity to buy what I want to buy. That was the argument that I made on the unisex issue. I didn't like someone telling me I should have equality or equity defined for me. I wanted to define my own equality or equity. And although there are people like you and your wife who may be more conservative, there are people like me who have no children, and whose sister has no children. I'm going to have to survive on my own, and I don't want to keep my principal only to leave it to some college or pet fund. I want to use it until the time I reach 105 or older, and I want to be able to buy benefits with bonuses that will help me provide for that longevity. That should be my choice.

MR. BARKS: I'd like to make one comment. I think implicit in this statement is an assumption that no bonus is supportable. There may be some bonuses out there that aren't supportable. But I think if you look at the numbers and if you look at the products, there are a lot of bonuses and there are a lot of products that provide benefits for consumers who give up particular rights to get more benefits. There are costs. I think we're all aware of the costs that are generated from, for instance, disintermediation risk. We are all aware of the potential benefits that we can achieve by investing in long-term securities. We are all aware of the problems of trying to recoup acquisition costs with contracts that don't stick around, and those are real costs. The consumers can be given real benefits for making sure that the company is either not subjected to those risks or is given the opportunity to utilize those kinds of investments.

MR. EDWARD F. MCKERNAN: I am also one of the authors of the proposed Standard Nonforfeiture Law for annuities, and I have a couple of comments for the record. Someone mentioned that there's a 2% limitation on decreases in surrender charges. There's actually a limitation on the increase in surrender charges to 2% per year except in the year in which the surrender charge reaches zero. The proposal does permit cliff surrender charges. In addition, the proposal does permit loads in excess of 10% on premiums up to $9,500, which is an indexed amount.

Also, the handouts failed to mention all material facts of the proposal. I would recommend that everyone read the proposal before they reach conclusions.

MR. BARKS: And the proposal can be obtained from Jean Olsen at the NAIC, right?

MR. MCKERNAN: I believe so, yes.

MR. BARKS: Or can they contact you?

MR. MCKERNAN: They can feel free to contact me. Howard Kayton is the chair of the resource group. He would probably be the key contact person.

MR. BARKS: I'd encourage everybody to review the annuity proposals, the proposal for the life nonforfeiture law, the work that's going on in disclosure and the work that's going on in the annuity valuation law. I think those are all very important things that people should be involved in.

FROM THE FLOOR: Barbara, you talked about the retirement bonus, and the concept of contracts that do not have a cash value. It seems to me, particularly from the smaller company perspective, that the risk of disintermediation to pay that cash value is much less than the risk of additional mortality on a benefit that's not going to start for perhaps another 30 years. Can you comment on that please?

MS. LAUTZENHEISER: Well, I thought I had covered some of that and maybe I was not clear. I think that a key element here is that the disintermediation risk is eliminated for the company. This means that risk is not so high, they don't have to charge for that, and you end up with extra benefits payable to the policyholder in the form of a bonus. So, through bonus features we have an elimination of that disintermediation risk. No one has to take it -- neither the policyholder nor the company, and it helps with the solvency issue.

FROM THE FLOOR: I think my point, Barbara, is that the amount of risk being eliminated is nowhere near the differential of risk taken by the higher guarantees in some of the contracts I've seen.

MS. LAUTZENHEISER: I'm still not sure I know what you're saying. Are you saying that there isn't enough or too much benefit that's payable?

FROM THE FLOOR: Too much. In other words, I see this as pie-in-the-sky and some actuaries will be ransoming the company after they're retired.

MS. LAUTZENHEISER: I think that you need to take a look at some of the research. One of the difficulties that we've had is a lot of the research is relatively new, which gets back to my Phoenix Mutual statement. There were people who thought that the low net cost that Phoenix Mutual had was pie-in-the-sky. But when you looked at their data, you found it was justified. There are people who now look at yield curve theory and think it is pie-in-the-sky too. But if you look at the data on it and pay attention to yield curve theory instead of straight interest rate theory, you come up with a lot different decisions than you did before. It's a different paradigm. It's a paradigm shift and it's moving much the same as it was moving on universal life. I was told by Mike Cowell the other day about all the resistance he had from regulators when he wanted to introduce nonsmoker discounts. The regulators felt he was moving too fast. By the same token, I've been working on Equitable's unisex case. The opponents in that court case are faulting the insurance industry for having had a surgeon general's report out there for 15 years before anyone did anything with it. Hence, they are faulting us for moving too slowly. Well, of course, at some point you do the research and you do use it. So the research that I have seen is that it's not pie-in-the-sky. It actually has some value, and I'm asking all of you to begin to look at that research and make different decisions based on testing, which means using the legal definition of equity instead of using stereotypes or perceptions.

MR. JOHN W. H TAYLOR: As we continue to move rapidly down this path, I hope we at least consider some other countries' experiences and avoidance of problems because they've avoided the nonforfeiture laws that this country has established which are, in effect, a continuation of thoughts and expressions of 1868 and 1876 and 1886. I am certain that if they had our nonforfeiture laws for life insurance and annuities in England, most of the companies in England in the 30 years after the Second World War would not have been in existence. I think they were able to avoid some of our problems by strict regulation of the industry which still allowed bonus programs that let them reset their cash values annually.

MS. LAUTZENHEISER: Walt Rugland, both because of his presidency in the Society of Actuaries and his job, has been doing a lot of international travel. I will paraphrase Walt. He says, the other nations are literally laughing at us because we are the only nation with an unregulated economy and highly regulated surrender values, thus putting us in the worst of all possible worlds.

MR. BECKER: I'm kind of concerned about that proposal in an environment where you might have many rather small companies that don't have the kind of actuarial expertise they need, or don't want to pay for using it.

MR. TAYLOR: I think the solution would be to require certification, to require professional standards, and to require independence of the person providing that standard. Maybe one of the issues is that the SOA should start considering its independence position.