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A New Look at U.S. Nonforfeiture Regulation

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Summary: The NAIC, the AAA, and the SOA together have been developing a new approach to the nonforfeiture regulation, an approach that will put more responsibility on the actuary to determine "equity." This session will bring attendees up to date on the current developments and status of the new law and provide for audience input on several controversial issues.

Mr. Douglas C. Doll: I've been involved with nonforfeiture regulation since 1985 when I was a member of the AAA Committee on Life Insurance. We were asked by the NAIC to address nonforfeiture concerns for universal life. We put together a report. The NAIC Life and Health Actuarial Task Force (LHATF) felt that our report's conclusions were not sufficient and, upon further reflection, thought that what we really needed to do was to look at the whole nonforfeiture law, rather than just universal life. Ever since 1986, there have been numerous proposals on how the standard nonforfeiture law might be changed.

An Academy committee came out with a report in 1989. I was also a member of that committee. They proposed a methodology that was not far different from what we have now. The NAIC Actuarial Task Force did not accept the conclusions of that report, and they developed several proposals themselves. Many of those involved a retrospective-rate-regulation approach. Those didn't advance very far. About a year-and-a-half ago we decided to start with basic principles and open up the possibility of giving the company actuaries more freedom and judgment at setting nonforfeiture values. That's how we got to the current state of affairs, and I'm going to let the other two speakers carry us forward from that point.

Our first speaker is Bill Carroll. Bill has been involved with nonforfeiture regulation since the 1980 amendments to the standard nonforfeiture law. Bill is a member of the SOA Task Force on Nonforfeiture, which recently completed a report, and he is also a member of the AAA working group on nonforfeiture. Bill will present the results of the SOA report. Our second speaker will be Barbara Snyder. She is also a member of the Academy working group, and she's going to bring us up to date on what's happening with that group because their work is still ongoing.

Mr. William Carroll: I'm going to talk to you about the SOA Task Force on Nonforfeiture. I first need to put in a little bit of a disclaimer. I'm employed by the ACLI, but I'm not speaking on behalf of the ACLI today, although I understand their positions, and support them. I'm a member of the SOA Task Force, but I'm actually not speaking on behalf of it either. With regard to its report, we've argued about all those words, and we agreed on publishing those words, but we haven't fully agreed on what they mean. Donna Claire is the chair. Our report is available on *Actuaries Online*.

Doug gave you the background on how we came to be a task force. I'm going to talk about our key charge from the NAIC. We were an SOA Task Force charged by the NAIC to do a job for them. Then I will go over the key findings and the conclusions, and I will tell you what I think is going to come of all this. We're fortunate to have with us Commissioner Wilcox from the State of Utah; he has been a key regulator in overseeing this activity at the NAIC.

The NAIC gave us several pages worth of material, which constituted a charge, and we had the opportunity to listen to their discussions. They talked about a minimum standard of return. They talked about making sure that we didn't discourage innovation and plan design. They talked about maintaining equity and making sure that the people who quit early, who quit in the middle, and those who quit at the end of the road got a fair deal.

We focused on one thing that they said. They may or may not have intended that we focus so heavily on this, but we did. Persisting policyholders should not be significantly advantaged or disadvantaged by terminating policyholders. We believed that the essence of our job was to translate this charge into a framework that could be used to develop regulations on nonforfeiture.

Our key findings, which are discussed in the central body of the report, begin with a discussion of the questions: Is it necessary to have required nonforfeiture benefits at all? If yes, how should they be measured? When should they be measured? Should there be a minimum standard of return? Are cash values themselves necessary? Should there be minimums and maximums or just minimums? Do these values have to be smooth?

Rather than me simply telling you what the task force decided, I'm going to put the questions to you one at a time, and we're going to get a show of hands to see what you think the answer is. I thought we'd divide the group up into two sides for the purposes of asking these questions. The folks on my left, put on the mindset of a regulator. When I ask you a question, respond as though you are regulators. The folks on the right side represent the industry.

From the Floor: Who's the consumer?

Mr. Carroll: The industry believes that it sells products designed to best benefit the consumer, and what's good for the industry is good for the consumers. The regulators believe that they're there in place of the consumer, and they're listening to the needs of the consumer. However, there are others who represent themselves as speaking only on behalf of the consumers. Are any of those in the room? They may sit separately and vote separately. All right, there aren't any.

First question, Should nonforfeiture benefits be required or should we let the buyer beware? First, what does the regulator side say? The regulators are heavily for it. We have a couple who say no. On the industry side, should you be allowed to do what you please, as long as you put it in the contract and tell everybody about it? There's a 50/50 response. The task force said that we take no position on this fundamental question because there's no driving actuarial principle that answers this question. This is a public policy matter. It's a regulatory matter, and we wouldn't criticize our actuaries in our countries who work in environments where there are no cash values. They have no need to stand up and say there ought to be cash values.

Do cash values have a cost? Is it going to cost more to provide cash values? Or, is there some sort of neutral cash value for which, if you provided it, there would be no additional cost involved? First, the regulator side. Do cash values have a cost? They say yes, with a few saying no. Over on the industry side, do cash values have a cost? They all say yes. What did the committee say? It says that (notice how we hedge?), mandating nonforfeiture benefits may increase cost for some coverages, and this may result in higher premiums.

Now to the more difficult questions. There are two competing views of nonforfeiture values in the actuarial literature. A retrospective view and a prospective view. Should we take a retrospective outlook, and consider what's a fair amount to take out of premiums for benefits and give back what's left? Or should we look prospectively and consider what policyholders get if they had stayed and paid the premiums? Industry first: should we have a retrospective standard or a prospective standard? The retrospective has the majority. Over on the regulatory side, all in favor of prospective? Almost none are in favor. All in favor of retrospective? It's overwhelming.

The task force said prospective. Bear in mind that we were driven by the NAIC charge that said we should maintain a balance between persisting and terminating policyholders. The classical method of ensuring that the person who is leaving is in equal position with the group who are staying is to look prospectively. We came down that way, and that has been the source of most of the criticism of our work. There was a lot of discussion about the view of the consumer; we spent more time talking about what the consumer might expect as opposed to would they understand.

The next question is, given that we've decided to use a prospective sort of measure, what should we take account of in this measure? Should we include only guaranteed values? That is to say, we'll look for the present value of future guaranteed benefits, and then we'll take off the present value of future premiums. Or should we cast that aside and take the present value of the benefits that you expect, and include nonguaranteed elements in this prospective calculation? So the question is, should we include non-guaranteed elements in the determination of fair value? The industry side first, should we include non-guaranteed elements? A few say yes. Should we not include non-guaranteed elements? More than a few say yes. Over on the regulatory side, should we include the non-guaranteed elements? Should we *not* include the nonguaranteed elements? Again the “not include” has more advocates. The task force says that you should take account of both guaranteed and non-guaranteed elements in determining the fair value.

The rest of these questions are all consecutive in context. We've already decided on a prospective method. We've already decided on including non-guaranteed elements. The next question is, when should we do this calculation? Should we make these calculations at the time of issue and set this whole deal forth in the policy? Or should we make these calculations as we go, readjusting as we gain whatever knowledge or information about how we've been doing or what we think might be different in the future? Should we set values at issue, or should there be flexibility to adjust them after issue? On the regulators side, set them at issue? A few say yes. Should we have flexibility to reset after issue? More than a few say yes. Over on the industry side, set them at issue? A couple say yes. Set them afterwards? More say yes. The task force hedged again. We say you can do it either way.

We have in mind a concept that doesn't show up in the report (and Barbara will talk about it). It's the notion of a plan. Driving this whole process is the notion that the company ought to have a plan. It ought to somehow articulate it so that an informed reader could tell whether or not they've been following it. The company should somehow communicate it, and then it should proceed to follow it. If it wants to change the plan, it should go through whatever disclosure and discussion with the state is necessary. The reason for hedging on things like this is to say, some companies may want to have a plan that says the values are fixed, and other companies may want to have a plan that says, here's how we'll change the interest rates if certain things happen. There's a preference indicated in the report for redetermining the values at the time of termination, but that's only indicated as a preference.

Should cash values be required? That is specifically cash values, as opposed to merely nonforfeiture benefits such as paid-up insurance or even a paid-up annuity. From the industry side, should we be required to have cash as one of the options? A few say yes. The majority says no. Over on the regulator side, Should they be required to have cash value? This time it's close, but those pretending to be regulators are slightly inclined to require cash values. The task force said that they need not be required.

Should there be a minimum standard of return? This is a gratuitous comment made by the task force and they're basically saying no, there doesn't need to be a required standard of return. Nonforfeiture is about whether the terminating and persisting policyholders are given equal value, whether it's an equally good deal or an equally poor deal. This is us reasserting the prospective nature of our proposal and rejecting any kind of retrospective look to see if people got their money's worth.

There were a couple of other questions on public policy. Should this new nonforfeiture law be a required minimum? Or should it be both a maximum and a minimum, and you had better stay within that range? Should it be minimum only, regulators? A few are for the minimum only. Should it be a range and you have to stay inside of it? Even fewer say range. Over on the industry side, should it be just a minimum or should it be a range who says minimum only? Minimum has strong support. Very few say range. Your task force said that these are matters of public policy, and the task force takes no position.

The second public policy question is, Should there be some sort of smoothness requirement? Can the progression of values from year to year have sharp jumps in it? Or should it be somehow smooth? Who's for smoothness from the industry side? Who's for the no smoothness requirement? It's close to 50/50. Regulators, don't you need smoothness? Yes, they agree.

What's the outlook for all this? I don't think that the framework in the task force will form the basis of a dramatically new and different nonforfeiture law in the near future. My reason for this is that there's no strong driving force on either the industry side or the regulators' side. From the industry point of view, this is not something that we must have. At the time of the 1980 Amendments, interest rates were at an all-time high and they were fluctuating faster than we can change state laws. We needed to have higher interest rates and indexed interest rates. The mortality table was fairly out of date, so there was a need for change from the industry point of view. Reserves were too high, and cash values were part of the package.

From the regulators' side, we can see examples during the 1980s of significant events that forced increased regulation. The failures of major companies led to increased solvency requirements at the NAIC, such as risk-based capital, the accreditation program and the like. If there were significant nonforfeiture abuses that were widespread, then the regulators would have the ammunition to come in and say, there must to be a new nonforfeiture law now to fix this, and they would know exactly what they wanted to fix.

From my point of view, there's not a significant force to drive a change. I suspect many companies that are doing what they believe is an appropriate job of providing nonforfeiture benefits would want to go into this new framework and do somewhat the same as what they're now doing, but there would be a large added cost in terms of this plan and making sure that the new policy forms got filed and finding new language to put all this stuff into policy forms. There's just a long list of jobs.

So my conclusion is, the task force report is as dead as a doornail. I think, maybe, the way you voted helped to confirm this.

Ms. Barbara L. Snyder: I am a member of the nonforfeiture working group of the Academy Committee On Life Insurance. Most of the other members of the working group are in New York right now at the NAIC Life and Health Actuarial Task Force meeting. The work that the Academy is doing flows directly out of the charge from the NAIC as well as the work that the SOA has done on what we would call the more theoretical underpinnings. The job of the Academy is to take that more theoretical basis and look at turning it into a possible new nonforfeiture law, and look at the practical implications of that and the practical approaches to getting there.

Doug has talked about the history, Bill about the Society work, and I will talk about the Academy. I want to briefly go over what a proposed life nonforfeiture law might look like (a summary of the major features), implications of the law, and finally, and then the status of the work that we are undertaking right now. This flows from the NAIC and from the Society work.

First, let's talk about one major feature. In the proposed new law, cash surrender values are optional, but benefits in kind (that is, paid-up insurance or life payment options) are required.

Second, the nonforfeiture law applies to the total value, including the non-guaranteed elements. We had a certain amount of dissension as to whether non-guaranteed elements should be included or excluded, but it is intended that this would encompass the non-guaranteed elements as well as the guaranteed elements. In the current law, the minimum values are prescribed by law and the company then determines the total value with little regulatory control.

Third, values would be based on emerging company experience. I believe there would be a choice on this. A company initially could say that values would be guaranteed and no adjustment would be made, but companies would have the option of basing their values on company experience. Of course, the current law has values determined by the statutory formula, using the same assumptions for all companies. In the proposed new law, guaranteed nonforfeiture values are optional, whereas the current law requires guaranteed nonforfeiture values.

Finally, the proposed new law would have a company plan for determination of the total values. This would have to be prepared and perhaps filed with the state insurance departments. You would have a nonforfeiture actuary. We already have a regulation that's passed in one state and imminent in four or five others that requires an illustration actuary. Now you would also have a nonforfeiture actuary. Of course, under the current law, there is no company plan required to be filed with the state insurance department for your non-guaranteed nonforfeiture values. It's not clear whether the new law's plan would be filed with the state insurance departments. It could be required to be on file at the company. An actuarial certification would certainly be required, where the nonforfeiture actuary would certify that the company plan and the resulting nonforfeiture values satisfy the law.

There are a number of implications of the proposed law. There is at least a certain group of professionals, including actuaries, who believe that product innovation will be enhanced with no required cash values. You can invest longer. You would still, of course, provide benefits in kind, but there are options on what you can do within a policy and the values you can pass on to your policyholders, if you're not required to have cash surrender values. No required guaranteed cash values implies higher yields and lower cost with reduced risk.

There is some belief and evidence that it would be more difficult to continue certain types of practices that regulators are concerned about with regard to lapse support, although this has already been somewhat addressed by the illustration regulations. I believe there is also a “bait and switch” concern that would be addressed by this type of regulation. We need to look at a framework that would encompass the nonforfeiture law and the sales illustration law, so this would be one of a number of steps that would need to be taken in looking at the new regulation in total.

Along with the benefits of greater insurance values and product innovation is the potential benefit of bundling various coverages. In an earlier session, there was a discussion of being able to provide a wide range of services to the consumer through product innovation. Another benefit is more equitable treatment of continuing and terminating policyholders, which is the key premise of the NAIC charge. More consumer disclosure and strong disciplinary procedures for the nonforfeiture actuary would be required.

There are a number of concerns about the proposed law, and these are the concerns that cause a number of people in the industry, actuaries and nonactuaries alike, to have opposition. Additional costs? It's a certainty that anytime you have a change of this magnitude, the expense impact on companies is going to be significant. You have to develop new products. In order to be competitive in the marketplace, you're looking at new products, new filings, and many other things that happen, like the new systems, and the implementation. Right now, in many instances, you have traditional products that have a set of fixed formulas that feed into cash values and reserves. Now you're talking about a dynamic nonforfeiture value.

You could have restrictions on the cash value level. Most of the people in the room, from whatever framework you were working, said we should have minimums, but there were certainly a number who said we should have minimums and maximums. This is a concern in certain marketplaces that call for high, early cash values. Different types of policy designs could be restricted in those types of cases.

These are concerns by the industry over the disclosure and regulation of the corporate business plan and profitability level. When a company plan is developed, part of that development needs to include the “company share.” There is concern by the industry over the regulation of profit levels.

There also are consumer issues when you have policies without cash values and the misunderstanding among consumers or just the unhappiness that consumers might have when they only have what we would call a benefit in kind, but could not actually withdraw their cash. In answer to this, a company can offer products that have the cash value option. Given that there is a cost to that cash availability, there would be different products and different prices for those products.

Certainly a concern in any regulation that is adopted by the NAIC is consistency by state. The resources that regulatory officials have to oversee the laws and the ability for regulators to appropriately review and judge whether companies are complying is a related concern. Actuaries, I think, also have to be concerned with increased exposure to professional liability.

At the last working group meeting there was a feeling that there has been a slowdown in the progress of the project. This has occurred for a number of reasons. First, there has been a change in leadership of the LHATF. Even within that task force there appears to be a fairly even split of those that are strongly supportive of a new nonforfeiture law and those that are, at best, lukewarm on whether a new regulation is required. The ACLI has come out strongly against the proposed new nonforfeiture regulation. They are, in particular, opposed to the prospective methodology and, in general, not at all supportive of looking at a new nonforfeiture regulation. The Actuarial Standards Board (ASB) has not yet taken up the charge to develop standards of practice. When the illustration regulation was being developed there was more of a parallel path with the ASB looking at standards of practice at the same time that the law was being developed. This time there is more of a “wait and see” approach. As a result, progress is somewhat slower.

I think the industry is generally opposed, primarily from the standpoint of the cost and what they see as the difficulty of implementing a change as major as this, not that the theory behind it is terribly wrong, but just that it will cause a great deal of change and expense and retooling and resource and all of those things that are expensive to any industry. Finally I would say in general, that we have felt that the profession is not supportive. It could also be that we, not just as professionals but as representatives of the companies that we work for, also see the difficulty of implementing such a major change.

At this point, there appears to be a lack of a champion, or an individual who will stand up and lead the charge and say this is what we have to do start to finish. So by having an impetus or leadership that is not as strong, we see the work slowing down somewhat, but that doesn't mean the work has stopped.

Now I will to talk about the ongoing status of the project. Much work has been done. Many people have spent many hours on this, but there much left to be done. The working group is in the process of developing sample company plans. The ASB will need to develop the standards of practice. Various members of the working group have the responsibility for spearheading specific issues, such as small-company issues. There are SEC issues because you are talking about adjusting nonforfeiture values. And when is it that you begin adjusting to the extent that this could be the type of policy that would come under SEC jurisdiction? We're talking about adjusting based on company experience for mortality, lapse, and investment. We already do that in universal life to some extent, but we have variable products that the SEC has to approve. So there's obviously a line somewhere.

We have IRS issues when you deal with tax reserves and a cash value test on tax reserves. How do you define that if your nonforfeiture values are now fluctuating and based on company experience? You also have an issue with respect to the definition of life insurance and cash value accumulation tests and so forth. So you have the life insurance definition and also the company tax issues to deal with from the IRS.

We're trying to get further exposure of the proposal to the profession, the industry and other stakeholders, and we certainly need a refinement of a methodology to calculate values. What are the immediate next steps? Even as we speak, there's a presentation to LHATF going on. One thing that the Academy working group committed to providing was a study of the impact of premiums in Canada for policies that don't offer cash values. I wish I had those results for you but I don't. I hope we will get that distributed through Actuaries Online and other forums. There was a question of what happened in Canada when they began to allow policies that did not provide cash values. Second was a presentation of some specifics about what a company plan would look like and what types of things an actuary would be required to document, have available when certifying.

Mr. Doll: This has been very depressing so far. If I were Bob Wilcox, I'd be somewhat worried. I would like to present the other side of a couple of the comments made. The comment was made that there's no champion. We have Commissioners Wilcox and Bartlett, both influential on the NAIC's Life Committee, and they're very much in favor of this. It's part of the general goal of giving actuaries more autonomy and more judgment and less rote and regulatory formulas. I'm all in favor of that. You may be satisfied to settle for formula-minimum, regulatory prescribed nonforfeiture values, but more of you might be happy to get some of the restrictions taken off the statutory reserves. If we are not willing to step up and take some responsibility for nonforfeiture values, it's going to make it harder to get more responsibility for reserves.

Commissioners Wilcox and Bartlett can't do it on their own, but there are certain other actuaries who I think have taken on the role as champions. Barbara Lautzenheiser is an outspoken proponent of a new nonforfeiture law and of companies having more flexibility in their nonforfeiture values so they can provide more long-term benefits to life insurance companies. Walt Rugland has also recently indicated that he plans to try to take this issue to the companies and see if more support can be drummed up. Recall that Walt was an early champion of the valuation actuary concept, which, at first, also did not have much support from the profession. It's not quite as gloomy as you might think.

I'd like to address one of the big controversies here, which is the issue between retrospective and prospective. There's a great deal of opposition to the prospective approach. The opposition to the prospective approach seems to be, that it's completely different from what we've been doing; nobody's going to understand it. It’s also too volatile; you have a change in assumptions and the nonforfeiture values jump up and down. Finally, it's too subjective. The actuary changes his or her mind about what future mortality is going to be and again we'll have this discontinuity in nonforfeiture values, so there's a great deal of angst about prospective methodology.

The Society Task Force Report concluded that a prospective statement of equity doesn't necessarily require a prospective methodology in doing nonforfeiture values. In particular, it pointed out that, for example, a product that guaranteed all benefits at issue would satisfy the prospective definition of equity, that you don't have to have a product that changes its nonforfeiture values if mortality rates change in the future. Most products already pass on experience changes to the policyholder. If interest rates change, then the credited interest rate is also going to change by a similar amount, in which case, if you do the prospective calculation, there's really no discontinuity in the resulting value.

Ms. Snyder: I'm not personally opposed to a change in nonforfeiture methodology. I'm a product actuary in charge of the product division. I think it's a good thing for the industry and product innovation. My list of negatives, which may seem like gloom and doom, was intended to portray the project as dead, but just to say that there is a certain amount of opposition and concern. I think the process of change is going to continue to happen. What we need to do is make it work.

Mr. Carroll: I'm a good guy, too. I have worked hard on this, I signed the report, and I believe it's a good response to the charge. Even in absence of the charge, I would have supported the answers in the report. When I say that the proposal is dead, I mean to refer to a required methodology based upon complete application of the report conclusions, using the prospective method and completely flexible values. But that's not to say that there is not going to be a law based on some sort of compromise that takes care of needs and desires of the industry. That's what they do when they work things out.

I still would be surprised to see a major overhaul of the law because I think the cost formula doesn't come out positively on that yet. Barbara has recited all the costs involved in making a change. You must have on the benefit side, you've got to have an equal amount of benefit or it won't fly. There has to be either some force that requires the regulators to say, forget the cost, we've got to do it, or on the industry side, forget the cost, it's got to be done because we need to be able to do this, this, and this. When you ask yourselves, what can't we do that we ought to be reasonably allowed to do, you come up with a fairly small list.

Mr. Doll: I agree with Bill on most of that. At the last meeting of the Academy working group, there was a vote taken as to what people thought would be the probability of the new law getting passed, at least as currently envisioned, and the majority of people had fairly low probabilities attached to that.

In retrospect, I think the Academy task force made a strategic error in some of its early work because there were some numerical examples that they provided as to how the prospective method might work. They showed a couple of sample products and they said if mortality changed, here's how the values would change. Some people “freaked out” that the nonforfeiture values are going to be jumping around because the actuary changes his mind about future mortality. In reality, I think that all the products we have now could fit in this new prospective methodology because the non-guaranteed elements in the products basically offset changes in experience assumptions. There are still a few products where all the values are guaranteed; and that's going to be allowed too. So, for all our current products, this change-in-assumption basis shouldn't be a big deal. I think we ought to have a law that permits adjustments to the nonforfeiture value based on regulation, and the initial regulation perhaps only allows market value adjustment based on interest rate changes. Some time in the future, people can address what to do about mortality if you don't change the non-guaranteed elements.

Another concern is that calculation of the theoretical nonforfeiture values is a very difficult thing to do. I believe we're not going to require that all our nonforfeiture values exactly equal the theoretical value. We're going to develop a product with surrender charges and cost of insurance rates as we would like to have them and get our actual nonforfeiture values. We will also look at what the theoretical values are that would treat the terminating policyholders and the persisting policyholders equally. We can then compare them somehow.

An item that hasn't been addressed is what the limitations are going to be on the comparison. There is another way one could look at this. One could rerun the profit analysis, substituting actual nonforfeiture values for reserves and look to see what kind of year-by-year "book profits" you get. The idea is that, if the nonforfeiture value is an adequate natural reserve, you shouldn't get future negative profits. I think some sort of test like that is not very difficult to do. It's fairly easy to do a profit analysis. It wouldn't be any harder to do than what we currently have to do for the sales illustration regulation, where we have to do the self-supporting and lapse-supporting tests.

Mr. Christian J. DesRochers: Currently, products have both a minimum and maximum, and the minimum is the nonforfeiture law and the maximum is the definition of life insurance. When the definition of life insurance was implemented, we found that some products actually had a maximum that was below the minimum. So those products disappeared. Examples would be increasing single premium life and endowments prior to age 95, which are gone. Right now I think some of the difference in the minimum and maximum is in the current assumptions. For example, we have the reasonable mortality regulations. The 1980 CSO was sold to the IRS as allowable in the definition because it was needed for nonforfeiture. Has the committee considered the issue that, if we go to a current value nonforfeiture, that we are very likely to run into a situation where some of the product innovation that we've thought about simply may not be able to occur because we're going to have a real narrowing of this minimum and maximum?

I have a related comment that concerns the comments on bundled products. We've seen only one proposed expansion to 7702 and that's to add long-term care as a qualified additional benefit. Other than that, every time we've approached it, whatever is allowable has been narrowed. I haven’t heard a tax policy argument that we ought to be able to integrate life insurance and other coverages and grant the inside buildup. So I guess my questions are, Have we considered what impact all of this has on the definition? and second, Have we considered any possible effects on changes to the inside buildup coming out of nonforfeiture changes?

Mr. Carroll: I'll start by saying that the SOA Task Force and the Academy's working group did not spend a great deal of time discussing the consequences or the interplay between this proposal and 7702. We were aware of it, and we listed it among those things of concern that would eventually need to be looked at.

Ms. Snyder: We've had some preliminary discussions and have not gone into depth on it. As we saw the new proposed law progressing, we knew we would have to begin to sit down and start a dialogue with the IRS, on both the definition of life insurance and on the tax reserve issues.

Mr. Carroll: The other part of Chris's question was one of the advantages that has been put forth for this proposal, the ability to bundle different kinds of products within the package. I agree with Chris that the mindset at the IRS is such that they don't want to see any new kind of thing be given the advantage of the inside buildup.

Mr. Robert E. Wilcox: I have just a quick comment or two from the point of view of a regulator. I'm the Insurance Commissioner for the State of Utah and, in a lot of ways, it's unfortunate that the LHATF is meeting in New York while we're meeting in Florida. I think that it would have been much more productive all the way around if we coordinated the meetings so we could all be in the same place. All of you would have been able to sit in and listen to the debate among the regulators and hear the presentation. I think that there are some important points that we have to keep in mind as we're going through this.

A third of a century ago when I started in this business as a brand new actuarial student, I saw not only a dynamic and a growing industry, but an industry that was consistently gaining in strength each year and delivering worthwhile products to the people of this country. Perhaps my motivations associated with the life insurance industry have changed somewhat. Back then I was interested in this business because that's where I was earning a living as a new college graduate and that was important to me. Now I see an industry that has more to offer the people of this country than is being delivered. Our growth is not what it ought to be.

There are those who would say that while cash value life insurance may not be dead, it is at least sick, if not dying, and I think that's a disservice to the people of this country. We have more to offer than that. There are a number of ways in which we can attack that problem, in terms of altering the product that we offer, to make it more attractive and one that will better serve the consumers that we are, each of us, trying to say that we're here to benefit. We need to look at each of those.

The nonforfeiture law is not the only element of the equation that needs to be examined carefully to see if there's a better way to serve the consumer. The thought process that is going on, and that has gone on over the last year-and-a-half, has been a critical one. I'm focusing on the last year-and-a-half because there was a change in direction at that point. We turned a corner and started looking at this from a different point of view than we had prior to that point. The things that have been developed through the SOA report and the sincere, honest, and great effort that has been made is not perfect, but it provides some very important elements that we can move forward with, modify further. We can come up with a product that can serve the consumer.

There will be a cost associated with doing that. What's the cost if we don't? Does the industry continue to slide down a slippery slope? Perhaps expending the money to revitalize our industry at this point produces a much higher return on the invested capital than any other capital that we might be able to invest. That's the sort of equation that we need to look at. Is change difficult? Of course change is difficult, but in our opening session, we heard some real reasons why we need to thrive on change rather then back away from it. If we back away from change, if we refuse to modify and revitalize our industry and adapt to the public that we now serve, which are not the same people that we served a third of a century ago, we are going to die. There will be no one left to fight for the tax advantages that the current law provides; it will simply go away because no one cares anymore. So I think that we do need to revitalize.

Another area that we need to be concerned with, in addition to the nonforfeiture structure, is the distribution system. How can we market our product, how can we cover the cost of marketing our product, and how can that become more effective? One of the real problems that we have run into, in terms of the equity issue, is what do we do in the early years of a contract when there's no equity and there's a negative value associated with the contract. Do we charge people to terminate? Obviously you can't do that, but to provide the equity that the model says we should be providing, it requires that we do so. There's another way to solve the problem, and that's to create some changes in the way we market and issue our contracts, so that from day one contracts have a positive value, not a negative value. That's something that we have to look at very carefully.

I hope that those of you who care about the industry and who want to see it not only survive, but thrive, will take a good hard look at this, and be willing to be taken out of your comfort zone. They must be willing to be taken out of the area where they have a formula, know how to apply it, and can’t understand why someone wants them to learn something new. They must get into an area where we can present something new to our consumers that will enthuse them about this product.

There's no other financial industry that can offer to the consumer the products that we can. We need to capitalize on that, build on that, and package it in a way that will deliver to them the values that we can provide and no one else is able to provide. If we do that, the product won't be exactly the same as that developed through the SOA report, but it will be something better and one that will carry us on into this next millennium, with something that will be appropriate for our consumer and that they'll be able to thrive on.

I hope that if you leave this meeting with anything, it's a determination to find out how to make it work, rather than to figure out how we can stop it so that we can keep the status quo that we feel comfortable with. That won't succeed; if status quo is our alternative, we lose.

Mr. Jay M. Jaffe: I agree with most of what you're saying. I would like to add two quick comments, however. To achieve what you want, I perceive there to be two things missing from this and several other aspects of the work that has been done in insurance regulation over the last several years. One is that we need to make our product more user friendly. We have to look at what's going on in the world. The mutual funds are accumulating money, not because of what people are doing, but because that's what the consumers want. That is my second comment. We are not asking the consumers what they want and learning from that. I would request and encourage that we start from the premise that we want to have user-friendly products and that we want to ask the consumers what they want, not give them what we think they want.

Ms. Carol A. Marler: These are my own thoughts and don't necessarily represent where Transamerica is coming from. I totally agree that we must get the consumer involved in the process. I did an informal survey at home and asked my husband, and he had no doubt whatsoever that the cash-value calculation should be retrospective because nothing else made any sense at all. The second thing that has been on my mind is that we're still looking at the idea of having equity between the persisting and terminating policyholder. It’s a great idea but, as we went through the questions and answers, I found myself in a box where neither answer was acceptable; so something is wrong here. Maybe it's that very principle. Maybe we need a principle saying that the options we give to the policyholder must be properly priced, and we must let the consumer make the decision about whether they want to exercise that option or not.

Mr. Carroll: Retrospective and prospective, if everything fits and works nicely, as Doug pointed out, it doesn't matter. You get the same answer looking both ways. It only matters when things are out of sync and something has gone wrong or gone better than has been reflected. That's how we come down to it.

Ms. Marler: I see the concepts you're getting at. I worked for an annuity company in the early 1980s, and we had fixed-interest-rate products. It was really an interesting time to be alive. That is why the regulators are very concerned that we recognize the investment and those have to be built into the price.