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Last Link in Product Development—State Form Filing

Track: Product Development

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Summary: In today's highly competitive market, "time-to-market" is critical. The process of obtaining state insurance department approval is as important as the market research and design phase of product development. In this session, company representatives are joined by state insurance department representatives to address issues faced by companies in complying with the form-filing process. In addition, they offer suggestions and guidance in expediting policy form approvals.

Mr. David J. Hippen: The last link in product development—state form filing—is sometimes known as "the missing link." We have a distinguished panel. Sandra Meltzer is the president of Sandra K. Meltzer & Associates, Inc. She is a fellow of the life management institute (FLMI), a chartered property and casualty underwriter (CPCU), and a CLU. What is even less known is she's a math graduate. She really knows quite a bit about what we do. We have Karen Allen who is a guest panelist who tells me this is the end of her honeymoon. We must be nice to Karen. She's really Karen Alvarado now. Karen is the director of state compliance at Pacific Life, the closest company to San Diego. We will present some basic ideas. Then hopefully we will have some time for questions and answers.

We have a picture of the happy product development actuary who has just finished all the pricing. Marketing says it's a solid product, and likes the compensation package. The chief financial officer (CFO) is amazed at how well it meets the profitability requirements, and the actuary figures he's on top of the world.

Another picture shows the pricing actuary's boss after he talks with the compliance people about what it's going to take to get this product filed in all 50 states and

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Washington, D.C. The picture shows a spear going through his heart. This picture is often the way that folks think of state compliance. I've dealt with state compliance from both sides for about 20 years. I've always felt that we were always on the same side (my job inside regulation was not a lot different than the industry job I had helping companies get products in place to sell them).

If we can strike an agreement, whereby the company that has done this great product is in a position to sell it, we can both win. That is because the real enemies are the twin dragons: insolvency and ill will. These are not always the product development actuary's top priorities. Marketing brings you a great product idea. The agents are anxious to sell it; they say they can do a lot of good things with this product. Marketing is all excited, not only about what it means for the individual agents, but to the company as a whole. The company is profit-oriented, whether it be mutual for the policyholders or stock for the shareholders. But the worst thing that can happen is for these new products to lead to insolvency.

Now that's not likely to happen with very many products all by themselves, although it occasionally is the case. In Florida, we ask a lot more questions because of our filing laws than in most states. I remember asking a question about asset/liability matching on a product. The actuary tested the New York Seven, and reported that three of them put the company under water. The worst one was the current scenario.

I had a distinct feeling that the actuary was asking me to disapprove this thing. The company would be insolvent if it put it on the market. We disapproved it. We didn't get into details a lot because, even in Florida, we can't do our own asset-liability testing on a product coming in. We also are not very interested in that level of detail. Six months later that product was refiled. I don't know what was changed, but suddenly the actuary was reporting that the New York Seven looked solid.

Of course, we hoped that this change in results was not because the management pressured that actuary into changing the results of the New York Seven. State regulators do not have the time nor the resources to test for themselves whether a product is going to cause a problem. We can look for problems, and we try to, so that we can help companies avoid insolvency.

The other aspect that we try to look at with state form filing is much trickier, and that's to try to avoid being inundated later on with consumer complaints. It's very hard for state regulators to foresee what the consumer has to complain about. Again, all we can really do is ask questions; hopefully you'll have the answers. But as you're designing products and trying to put together prices, try to foresee what might cause consumer complaints.

The fact that a state approves a product does not mean that it's completely in compliance. It does not mean you won't have complaints. It doesn't mean that you won't cause the company to go insolvent. It only means you can sell it. Although states and regulators have tried to beef up the credentials, competency,

and resources, the real guards against insolvency and consumer complaints (leading perhaps to losses and even possibly litigation) are the actuaries.

As a regulator, it often seems to be a thankless job; you are in the position of the person that has to say "No." The actuary who filed with the insolvent New York Seven probably tried (and failed) to say "No." Sometimes you're not in a position where you can stop something by simply saying "No" to marketing or "No" to the CFO. The actuaries are really on the hook.

Many might think that it's okay to overlook a lot of things because if the product goes well, you'll be promoted. You'll be at the other side of the building when the losses and the litigation hit, and nobody will ever know that you could have stopped it. One thing that's true about actuarial work is that most of it is long-term. What you do or fail to do probably won't cause a great deal of grief the first year, unless it doesn't sell. Long term, the business has to stay on the books for the company's profits to be realized, and for the consumers to get what they paid for.

Who's responsible? The insurance company is responsible. Virtually every state has an item in its laws stating that a contract that is not in compliance will be construed as if it were in compliance. Simply put, this means that if 30 states approve, you can sell it. If you find out afterwards that what you sold isn't in compliance, it can be compelled to be in compliance, and those measures can be a little bit ugly.

I'm going to tell you a quick story. I've worked for enough places so that hopefully this won't offend the guilty. I had a client when I was in the industry that was not correctly calculating according to the tax law. It turned out that I was the third actuary that had in effect said, "You need to fix this. This is wrong. It may be close but it's wrong, and you're going to have problems." I was told, "That's a major system modification. That'll take us a year. We don't have the priority. We don't have the money."

While working for the State of Florida I received an emergency filing from that former client. The emergency was that the IRS had showed up, and had announced that the actuaries had been right. The insurer's calculations were wrong, and they had six months to fix the problem, announce to the whole world that they were wrong, and tell those policyholders that their contracts were out of compliance, and that the insurer was liable for the penalties. Talk about a marketing blow! I was perfectly happy to speed that filing through. What a sad end to a story.

Regulators are responsible to look at things, but honestly it's a little bit unusual if you file a product with a state that has a specifically qualified actuary to work on your filing. My background is specifically universal. But I'm only generally qualified in most areas. Most states's staffs don't have anybody with any specific qualifications. Even if they do, they often do not have the time to look at your filing due to other duties.

I worked for the State of Utah for a couple of years. I was the only actuary for most issues. I got the same several thousand filings a year that we in Florida split among six people. In Utah I had time to look for two or three things that might be wrong, and the rest was up to the company. The universal life demonstrations that were in compliance were all ten to twenty pages. We knew that if they were that long that we might as well rubber stamp them because there was no time to read ten to twenty pages on every filing.

If you're really on the hook, the regulators are a backup. That's all we can be. We try hard, though. If the agents and the consumers end up responsible, it's because we haven't done our job. If the agents catch that you're doing something wrong, you know you've really messed up.

Thankfully, most of them will let you know so that you can fix it. If the consumers start letting you know that there's a problem, they're also very likely to let regulators know (those who are in the market conduct or solvency section). If they're letting those folks know, you're in trouble. We actuaries need to take the responsibility.

We need to maintain very high standards. Excellence is the only standard that works in a profession. This is a profession. If we intend to keep it a profession it has to have excellence in integrity, thoroughness, and work. We obviously have to be efficient.

Clearly, the NAIC's push for speed to market is a response to some perceived inefficiencies on the part of the states. It really is tough to start looking through a filing and realize that the problems with this filing are not because of a quirk in Florida law. It's just that I'm the first regulator who has had time enough to find it, so there might be sales going on in 30 states with this product in spite of its flaws. That makes me very uncomfortable. If speed to market wins the day, and especially if, as has been proposed, file and use becomes the rule, regulators will be pretty much off the hook until it gets to insolvency and market conduct.

It is much easier, as we all know, to eat well, sleep well, and get some exercise, than it is for the ambulance to pick us up and try and fix the problem if we don't take care of ourselves. If the state regulators on a file-and-use basis have to fix the problem, it will be "ambulance" time, and there may not be a 100% survival rate.

Regulators can help as we're looking for equity among the different customers that you have. You have your company, the client, the agents, or the policyholders. All those folks deserve to get a reasonable value for what they've put in. Although you may be told that you only have one customer (and you may have a primary customer), you cannot ignore the policyholders whose only hope is that you've done what they thought you did; that what the agent told them is really going to happen.

We had a little discussion in the session on term insurance regarding "How to make non-guarantees look like guarantees" Former Utah commissioner Bob Wilcox stood up and said, "I'm not comfortable with that as a former commissioner or as an actuary." I had an idea of what the actuary there was trying to say. But we need to be able to change the laws so that we're conforming to them, not getting around them and creating a horribly non-level playing field. You might think, "Well, I figured out how to do this so that nobody knows what I'm doing." That's called deception. But if we can change the rules, and make them more flexible, and make them work without losing excellence and equity, we can have the efficiency that we need.

What do we do to solve these problems? Create opportunities. We have the Actuarial Standards Board (ASB). The ASB is wonderfully responsive when a new regulation comes about, helping actuaries know how to be in compliance with it. The ASB is a wonderful way to be regulated compared to having the SEC or the Federal Trade Commission (FTC) try to figure out, first, what an actuary does, and then tell you what that is. I personally would shudder at someone who never knew insurance trying to tell me how to do my job as an actuary. The way to forestall that is to have standards that keep us out of that arena.

The NAIC is trying to improve. I'm impressed with what the commissioners are trying to do to be responsive to the need for speed to market, with the need for more uniform standards. When we as regulators see a problem, if we try to develop something to solve the problem, the protest is, "There are 30-40 other states that don't see it that way." More likely, there are 30-40 other states that haven't had time to think about the problem because there is just too much to do.

As taxpayers, most of us are not excited about increasing the size of our taxes, so we're not excited about increasing our government. But if we want to continue to have efficiency and effective regulation we need to be responsible, and take the brunt of the work of making sure that what we produce will not cause insolvency, and will not cause ill will. The SOA and the Academy have been very helpful. We need to make sure that we're willing to put back a little of what's given to us. You know when you get those credentials, like ASA, FSA, and membership in the Academy, they leverage your educational attainment into a very much higher-than-expected standard of living.

The folks who rely on us figure that professionalism is the reason we're paid the big bucks. They don't know why on earth a mathematician otherwise would be of any interest. My wife certainly doesn't know why I'm of any use at home, especially when I don't balance the checkbook right. We have to be attentive to what we need to do professionally. We need to participate to make sure that the standards are high enough so that speed to market doesn't result in double jeopardy: insolvency and ill will.

We need to participate. Support sound statutes and standards. In Florida, we are probably pushed as much as any state to only regulate to the extent that the law exists. When the law doesn't fit, regulators might be relatively powerless to do

anything to change it. What is becoming more common is how Florida's statutes specifically tell the Department of Insurance not to adopt regulations unless we have to. Most of the time it tells us when it's time to adopt one. If we try on our own we don't usually succeed, so we don't often try.

Triple X has been a big controversy in Florida. It surprised many of us in Florida. We have had a very slight conflict in our statutes in the standard valuation law. Somebody years ago tried to do an advanced version of Triple X, but it's not the same. They put it in statute. We don't change the statute in the department; the legislature has to do that. Recently, the legislature passed a bill to enable the department to adopt XXX. Now the legislature said the effective date might be January 1, 2000. I'm reviewing product filings made in June, and the bill had not yet gone to the governor when I left for San Diego.

The solvency actuary and I have a coin flip on whether the governor will sign it or just let it pass into law. We doubt it will be vetoed, but we can't act on it because it's not the law yet. We are relying on our ability to follow the NAIC to look at what's being filed now. The actuary is going to have to be responsible. For filings the first five months of this year, nobody had a clue whether XXX would go through. We still don't know when, and we don't know in exactly what form.

For the actuaries who filed those reserve demonstrations trying to comply with the old law might have enabled the company to sell. But if the actuary isn't right on top of what's happening July 1, September 1, and January 1 of next year, the product reserves might be totally out of compliance before it ever gets to the field. The actuary is going to have to work to keep up.

One of the things that actuaries have to get better at is explaining their positions to people that aren't actuaries. The two other folks on this panel have to deal with that on a regular basis. I know from experience that compliance for state filing is often not at the top of the priority list for a product development actuary. You may not get a lot of praise for what you do with regard to compliance (unless you get it past Florida). But you have a responsibility to work with the folks who are doing the compliance.

It is very baffling, for example, when I get a call from a compliance person who is trying to figure out how to calculate a cost index. I ask, "Can't you talk to the actuary?" It's a fairly simple calculation for any actuary if they've been doing it for 20 years. The compliance person responds, "the actuary won't talk to me. He or she is on to the next project and tell me it's not really a priority. It's my job. I started a couple of months ago. I'm planning on taking a couple of Life Office Management Association classes. I don't really know what I'm doing." It's very awkward at that point to help a compliance person through the filing.

My challenge is for the actuaries to do what they can to make sure that everybody, from marketing, to compliance, to legal, knows what's behind what they've developed, so that it's clear when it goes to the state for filing, that if there are any glitches it's not because you're unprepared, but because there are just some

questions that need to be answered. That will create the efficiency that we're all looking for. One of the happiest things I get to do on a Friday afternoon is to call a compliance person to say that their filing has been approved; there weren't any problems with it.

Ms. Sandra K. Meltzer: State filing is our marketing approach, marketing for our services to our client. Now, I really view policy form filings as a maze. You have to go through the maze for all 50 states to have a successful filing countrywide. It used to be, years ago, that you could send out a generic filing across the country and meet with fairly good successes. Those days are long gone. Now you have to look at each state, see what it requires, and give each state what it wants. If you don't do this, chances are a lot of those filings will just be bounced back at you saying, "Hey, do your job."

The first thing that you have to look at is the product type. Is this something that the states are familiar with, or do you have this new, great innovative product, that your marketing people have come up with, that nobody has seen before? That's the hard one, because you have to start out in the transmittal letter to tell the state regulators just what this product is. What is in it that is different? What do they have to look at that they have never seen before? Give them a heads-up that they're going to be seeing something different. That way they won't bombard you with questions and irritation because it's not something they've seen before.

Regulators are very busy. Departments are short-staffed, and they like to at least have some notice of what they're going to be looking at if something's new. Once you've done that, you have to think, "Where's my state of domicile, and what states require us to get our state of domicile to approve our product before they'll even look at it?" There are only four states: Iowa, Montana, North Carolina, and Utah. But many other states want to know what the status is in your state of domicile—have you filed there and is it pending?

Then you need to look at the state's provisions. What do they mandate? Which are the usual provisions? I'll give you a quick list: grace period, reinstatement, incontestability, and on through a whole bunch of things you have to have in a policy. Free look varies from state to state in language, duration, and fraud warnings. Then you get to the application and your underwriting. Applications have become extremely difficult because of AIDS, AIDS testing, and health questions. There's even a question of genetic testing. Several states have passed laws that say you cannot use genetic information. Louisiana has passed a law that says that you can't even use family history because that's considered genetic information. Things just get more complicated and more difficult for the contract and for the underwriter.

What do you need in a filing package? Many states require compliance certifications where an officer of the company signs his life away, saying that you're in compliance with the state's rules and regulations. You need actuarial certifications about your reserves and your cash values. You also need Flesch scores, which are readability requirements, and a certification that you meet the requirements of the

state. Then most states have a form for the submission that you have to fill out with information about filing fees and information about what it is you are filing. If you put certifications and submission forms together in a stack for all 50 states, it can be about an inch thick. You have to address each one separately with NAIC numbers, (federal employer identification numbers) (FEIN), and state insurance codes, so all the states have all the information that they need. That is how you get your filing done so that none of the filings come bouncing back. You've done your homework and you're actually getting comments back from the state.

Many of those questions that you get back are not disapprovals, just simply questions for more information. Sometimes the actuary has questions. Sometimes they want to know how you're going to market this product. Sometimes they actually object to a concept you have in the product that your marketing people are very proud of, and think that this is a great innovation. The states will come back and say, "We don't know if this is so good for the consumer. You have to rethink this or answer all these questions we have about it."

Then there are objections to policy language. As an example, one state will not accept the phrase "satisfactory proof of death." They want you to say "due proof of death," which is semantics. But it's surprising how many states have those little word changes that you have to make, because that's what their law says. They feel that they cannot deviate from what their law says. Even though it's really immaterial from my point of view, it's not immaterial from theirs.

When you get objections, it's really important to take a look at the letter that you get. What is it that they want from you? What can you argue and when do you just give in? My suggestion always is, if the change does not affect your product concept, profitability, or anything essential about the product, just do it. Laws are very difficult, very confusing, and very different from one state to the other. Regulators are constrained to follow the law of their state, and you just give in when you're not going to accomplish anything by arguing. Sometimes you win and sometimes you lose when it pertains to issues that are material to the product. You have to be very careful.

One of the experiences that I had that was very disappointing was with indexed annuities when they first came out. We filed one of the first products that was out on the market and it just whizzed through all the states. The second one we filed took a little more time. There were more questions, and then lo-and-behold, the state regulators started sending us letters. The letters said they were withdrawing this product, and we couldn't issue this product in our state. The regulators really didn't take the time to read it and understand what was going on the first time. When they had a chance to look at it more closely, because they kept seeing more of these, they realized they were not comfortable with that concept.

It was something new, and they felt the companies were at risk, and they had some questions. Who is managing these funds? Who is determining what the investments are to get these equity-indexed products out on the market? Companies had a hard time answering all these questions and this lengthened the

process for companies and regulators, but the state had a genuine concern. Although agents were very anxious to get this product out into the market, they just had to take their time and answer the questions.

One of the things that has been suggested many times is to use a discretionary group to get a quicker product to market. It used to be that was a pretty good strategy, but lately, it is not. There are about ten states that will not accept discretionary groups. A discretionary group is where you set up a trust and the master group contract is issued to the trust in one state, and you issue certificates in all the other states.

Ten states won't allow it. In about ten states, you can do it without filing. About six states have what they call a three-prong test. Can you prove savings in administration? Are premiums adequate for the benefit provided? Finally, it cannot be against public policy, or something like that. But if you can prove that it has been approved by a state that has a similar law, they'll approve it.

That's 16 states that aren't too hard to pass, but the others are very difficult, because instead of just having questions on the product, they now have questions on the nature of the group. You have two fights to fight. One question is about the nature of the product, and whether it's a good product and is in compliance. The other is about the nature of the group and whether the state will accept the group even on an out-of-state basis. The only time that I suggest going the discretionary route is if you really need flexibility in your product that is usually found in a group product. Otherwise, it's just not worth the extra effort in setting up a trust and going through all these questions about the nature of the group. In that way, things have really changed.

Another issue is, how do you address policy form and consistency on the part of state insurance departments? I'll tell you one of my experiences. I filed the same policy for sister companies at the same time. There were two separate filings with a cover letter saying these are sister companies with the exception of the insurance company and address; the forms are exactly the same. In most states, the two policies stayed together and were examined by the same examiner. In several instances however, they split up the two filings. I received two objection letters from two different examiners in the same department that were totally different.

How do you resolve this? It's very sticky. You can't go to one and say your colleague said this, so you're wrong. I answered both letters to both regulators. I complied with everything in both letters, and got an approval. The other problem is, your product was approved six months ago. You're filing a similar product today. You get a bunch of objections that are nothing like the ones you got before because you fixed everything in this filing that you fixed before. You now have a whole new set of objections to deal with.

I guess the first instinctive thing to do would be to say "Hey, wait a minute; you approved this six months ago." That is not the thing to do. You never do that because what will happen is they'll probably pull that product. You really have to

start from scratch, look at the new objections, and see what they are. I say this with full confidence that you're not violating any state law because these comments are often subjective. They are not necessarily based in law, but just on the regulators' top drawer rules. It is based on what precedents the departments have set before. These rules exist in many, many departments, and you are not aware of them until you actually do the filing.

The state insurance departments are dealing with some of those problems by putting their filing requirements on their Web sites. That is helping to clear up some of this misunderstanding and vagueness in their requirements. For instance, about three years ago, New Jersey took all their top-drawer rules and guidelines and made them official rules. If New Jersey has an objection, and they always do, you at least have a citation to go to and you know exactly what it is. They have limited their subjective comments.

But, as I said, it is subjective in many other states. You have to talk to the analysts, make a telephone call, and try to work out just what the problem, what they're not seeing or what they feel is not correct. Be nice; smile as you're doing this. Have a pleasant tone in your voice. Don't be angry and frustrated because your marketing person is beating you over the head to get this approved. Also, don't take it out on the regulator. Discuss with them what it is you need to do to get this done.

My experience has been that regulators are very happy to talk with you, and will suggest what they want you to do. Now that doesn't mean that you will like what they want you to do. That's the point of negotiation. That's where you talk, and when you've done all this, you've gotten through it and you've got your product approved, and your marketing people are just delighted with you.

Ms. Karen J. Allen: I just want to touch a little bit on some things that both Sandy and Mr. Hippen talked about. I'm the director of state compliance of Pacific Life. I have the wonderful task of writing products, and the pleasure of working with our product development actuary very closely in developing the forms that we submit to the state insurance departments.

First, I'd like to say that your involvement in the process with the state compliance person is critical, because we're not actuaries. I'll have to tell you that the highest words of praise I've gotten from our chief actuary when I come to him with a problem and with a proposed solution, is, "You know, you're starting to think like an actuary." I'm assuming that that is praise.

Let me talk to you a little bit about variable products. That is my particular area of expertise, and I want to talk to you about ways that you can be helpful in bringing a variable product to market. The first key thing is the prospectus. This is the huge, lengthy tome that we like to write and put everything in. We have all of the financial information in the prospectus, and information about the way that the product actually works. The input that you give is crucial for the financials. That's

the pretty obvious thing. The second way in which you can be most helpful is in looking at the language that we develop to describe the product.
When we tell you how a death benefit works, when we tell you how guaranteed income works in the prospectus, read it carefully. It has been my experience that when you get a committee of people, marketing included, that have some input about the way the prospectus reads, and how it should appear when it's sent out to the consumer, they don't always explain the features accurately. I know that comes as a shock to all of you, and you've never seen that before, but pay particular attention to things like, how a death benefit is calculated.

I've pulled prospectuses before, when it has come to me as kind of a final review, and gone to our actuary and said, "You know, when I helped you write this product, this isn't the way I understood that it worked. Could you clarify this for me?" Second, there's a big initiative right now called "plain English prospectuses." That means that we're going to take those 40-60 pages of assorted text and try to boil it down to language that someone reading at an eighth grade level can understand. It is a monumental task to get a group of legal people to make it simple, and then to try to boil all of that information down to a small, concise document that the consumer can understand.

The actuary is important in understanding our particular situation, and looking at it and helping me sometimes eliminate verbiage because it's my nature to put it in, and it is the actuary's nature to take it out, and we need to maintain the integrity of the design so the explanation is adequate.

Both Sandy and Mr. Hippen talked about, how everybody right now is being buzzed with speed to market. Our marketing people always say that if we just had federal regulation, all of our problems would stop, and you would be able to have a product on the street a month after we developed it. That's real optimistic thinking, and my opinion is that in the real world, that's not going to work.

The NAIC has put together the "speed to market working group." I have a copy of their initial tome (It's quite thick) which describes things it can do to help bring the states along in a quicker fashion. There's so much pressure with the passing of the Gramm-Leach-Bliley Act and the consolidation of the financial services industry, that you're seeing new companies now that are part bank, part brokerage houses, and part traditional insurance companies. My experience is that people whose background is banking and brokerage have absolutely no concept that state insurance law plays any part in the product that they're selling. It's probably the biggest point of discussion I've had with our marketing people, explaining to them that they have to comply with each state's regulation, even though the SEC might have given an effective date on the prospectus.

The speed-to-market working group came out with 13 new proposals. Here's how we can smooth the process a little bit. At the NAIC meeting in Orlando, they went from 13 to 4 proposals. They ended up saying that they were going to pursue some of them further with some modification. The first was approval in your domiciliary state with sort of a zone-approval approach, meaning that there would

be groups of regulators in your southeastern zone, whatever particular zone that your company is located in, that would have kind of an oversight of the process. The second was domiciliary approval based on some form of NAIC accreditation criteria that would be developed and enacted. The third one that was tossed around was some sort of interstate compact between the states that would agree on policy approval processes. There are some key problems with all of that. First, getting 50 insurance commissioners to agree is always a monumental task. Second, there is something that I think marketing is not really in touch with. You might get 50 states to say, "File it and use it." From my perspective, and probably from my product actuary's perspective, that could be kind of a worst-case scenario for us. Guess who is responsible then? We are.

We're responsible now, but we do have the state department that comes back and says, "You know you might want to think about this a little bit before you do it," or "Are you aware of this particular statute?" Then the burden of complying with each and every state regulation and statute will rest squarely on the compliance person, and we would love to share the wealth with the product actuary.

Those are the NAIC initiatives right now. The ACLI has recently published a paper that said that it might not be opposed to federal regulation. I would stress, as you go to your individual companies, and as you look at what all the possibilities are out there to "speed us to market," that you analyze each one of them very carefully. What is its impact going to be on not only the work that you have to do, but on the responsibilities of the company, and how you're going to be able to market.

Federal regulation (I've dealt with the IRS). I don't necessarily think that that's going to get us anywhere. I can just imagine trying to get federal regulation in place. Keep in mind that even if you pass a federal regulation guideline that says, "Here's what you have to do to have product approval." You need to be very aware that there's a ton of other state regulations and issues out there that you are still are going to have to comply with. There isn't a magic bullet out there that says, This is it. Now you can sell your product."

You need to very carefully think about different things. Mr. Hippen pointed out that the regulators are looking at a lot of material. I can testify to this. You get approval in 30 states, and then, you get an objection. A lot of times, it is the only state that's looked at it. I'll say that in their defense. Over the years, in developing working relationships with the state regulators, I've come away with an appreciation for the burden that they have.

I don't know how many of you have actually been to state insurance departments, but I've made many a journey. I can tell you that I have walked into offices where filings are stacked literally three and four feet thick. The volume is just incredible, and you have one person sitting there trying to juggle all of this. The other thing that I would say in respect to being proactive is that you should look at what you can do to assist the state regulator.

There are working task forces. The recent change in New Jersey provisions became reality largely because there was a group from the industry that tried to work with the New Jersey department to try to get some simplified procedures in place. The group tried to move them from straining at the gnat to focusing on the big bug out there so that we can eventually get products approved. It was successful. Both sides entered into the negotiation stage with mutual respect, and I think that that's really critical. There's a lot of opportunity out there right now for us to have an impact on how the insurance business is conducted in the future.

The last thing that I would like to stress is when your state compliance people come to you with a question. I know that you're busy, and I know that you have a thousand other things, just like us. Once a product is filed in my marketing department, it seems my job is done. Of course, that's when the responses start coming in. When they come to you with a question, try to give them a response in as quick a manner as you possibly can, because a lot of times we're really under the gun to respond in five to thirty days.

Then we're the ones who are going to have to explain to marketing why the filing died. None of us want to say, "I sent that over to actuarial, and I didn't get a response." We're trying to be more proactive with that. It's a great working relationship with compliance and the actuarial department.

Mr. Hippen: Sandy mentioned something that is pretty common when you're a regulator dealing with filing. I've worked for three different states over the last 20 years. Their requirements, staff, resources, and some of their laws are different. One of the standard responses, when I have a question about a filing is, "This was approved in 30 states, so what's your problem?"

What that tells me is that you probably have a problem in 31 states, if my law is no different from the NAIC model, and you're out selling, and I'm the only person so far that has stood in your way. An even worse comment that I hear all the time is, "I filed a very similar product six months ago, and now you've raised all these objections." My reaction is that this is like telling the officer who has just stopped you for speeding that you've been going 90 in a 60 zone for the last six months; in fact, you've told all your friends that it's okay to go 90 on this stretch of highway. "How dare you stop me now?" Or it is like passing through the intersection, being stopped, and reminding the officer, "That stop sign was down for a few weeks, so I figured it didn't count anymore. You didn't catch me last time."

We actuaries are responsible whether the regulators catch us or not. Simply getting by 30 states doesn't mean you've done something right. In fact, it might mean you've gotten yourself in trouble because you have issued contracts that need to be fixed before you go on, and that is a very awkward process.

I know from working in each of those states, as well as from a product development standpoint, that trying to fix a product that is already out there (because a lot of states already looked at it and didn't see what was wrong) is a nightmare. You either have to have state-specific versions, or you must fix

contracts in states you've already started in, and that's awful. States do not like to be pushed to withdraw approvals. That's a nightmare.

There's nothing more inefficient than having gone through the process, and then having to pull out all the nails, mend all the holes, and start to build the house over again. From the regulator's perspective, who really thinks that what he or she is trying to do is administer the law, it is not impressive to say, "We're doing this everywhere else, and we've done it in your state before. You ought to just let us do it."

Mr. Michael Richard Tripsis: As background, I've had compliance departments of various types report to me for the last 20 years and have had a lot of experience dealing with regulators. It has been interesting. I agree with a lot of what was said. The question is not meant to apply to situations where clearly the company has designed a product that is in strict violation with the letter of the law, or is something that is not in the best public interest. I certainly don't disagree with anything there. I've found that those situations are a lot rarer than some people think.

Ms. Meltzer gave me some thoughts that sort of echoed what I was thinking. We've had filings treated totally differently that seemed to have been identical. We've had requested language changes that seem to leave the contract virtually unchanged, but for a month's delay in its issue. Mr. Hippen indicated that a lot of times, it seems to be an adversarial relationship, and it seems to be obvious why that is.

I've had experiences over the last 20 years with regulators that don't seem to like the product, and make that very clear in the process. In fact, they wouldn't buy it, and they feel like they're defending their constituency in that light. Mr. Hippen also mentioned that one thing that we don't want to do is try to get around the law, but instead wait for change in the law.

Unfortunately, the law is never going to be detailed and precise enough to handle every situation, and we all know that. Every nuance of the product can't be accounted for, and that's why we have the regulators. Unfortunately, some of the regulators will essentially manufacture the law to suit their tastes and peccadilloes. At least that's the way it comes across sometimes. They'll use the more restrictive of either the letter or the intent of the law, depending on the situation. Now, if you appeal to the letter, the response is, "The intent of the law is this." If you appeal to the intent, it comes back, "The letter of the law is this."

They'll seem to be inconsistent on the application of the law or the regulations. Some companies will get approval for the same features and language that other companies are disapproved for. Products are approved and then withdrawn retroactively, as the state department seems to change its mind, making it an ever-shifting target. I empathize with the compliance departments on how difficult that is.

These are the kinds of things that seem to promote the treatment of the forms approval process as a game to win. These are the things that almost inevitably make the relationship adversarial. With all due respect, it seems wrong or incorrect to lecture actuaries for some kind of ethical deficiency for approaching the process in this way, when it has been set up this way. I would appreciate any of the panelists' thoughts, particularly Mr. Hippen's.

Mr. Hippen: It is an awkward position, and it is true that there are an awful lot of regulators who, over time, get used to the notion that they are in an adversarial position. Having been on both sides, I've looked at that with some chagrin on both sides, because I know that I'm human. Actuaries are not supposed to make mistakes, but they do. But in regulating, we're trying to administer the law. What that means does vary from state to state, and that is a very hard thing to deal with.

Sandra mentioned the change in New Jersey. For years, it was difficult to find out exactly what the standards were. In some states, if some high level person in the department thinks the law ought to say or mean something, they'll interpret it as if it did. I appreciate the need for the NAIC to have the support of the commissioners in working for more uniformity. That kind of thing doesn't seem that essential to the regulators.

For example, it was very awkward when the 1980 amendments were put in so that the 1980 CSO could be the valuation and nonforfeiture standard. Much of the language that was put into the statute was virtually the same as it had been for the 1958 CSO. Then the industry belatedly brought to the NAIC's attention that nobody did their whole portfolio at once anymore. The new statute, the 1980 amendment, said that as of a specific date, each company , would use the new standard for all of its new issues. The companies, after the fact, said, "Now wait a minute, that's not how we do products anymore. We used to have big rate books full of all our products, and when we changed them, we changed the whole book. Now we do it a group at a time."

The NAIC, in an effort to be helpful, approved an actuarial guideline allowing them to be done in groups. This was in direct conflict with the law. I happened to be in Utah, and we were one of maybe two states that were successful in getting the law changed. Most states don't have the help that they need from the industry to get the law changed so that it works.

It was amazing to me that the NAIC was told, after all of the work was done on the 1980 amendments, "Oh, that won't work that way anymore." Now that the statute had passed through sufficient states, so there was no going back, we need to have some sort of guideline or some unofficial nonlaw, nonstatute provision that sort of reverses what the statute now says.

That kind of thing continues to happen. It is very unfortunate when new products come on the scene, and the actuaries haven't thought through all of the ramifications. Maybe they haven't had time, or haven't taken the time—it's hard to

tell. Too often, the filing comes with a letter that reads, "This form contains nothing unusual or controversial," which seems to be standard language in some places. Yet it is the first time you've ever seen anything like it.

Sometimes we can work with the law. The law is flexible enough to allow for some things. It is most helpful for the company to help the regulator understand how. That's one of the pieces of the success of universal life. The actuaries did work hard to figure out how to show compliance, how to fit it in, and then they worked with changes in the law. Unfortunately, that process stopped when the model regulation was passed in 1983. There are ever-growing gaps between what's needed in universal life regulation, both for reserves and nonforfeiture, and what's really happening.

It really would behoove the company that is developing the new product to figure out how it complies with the law and then try to help the regulator understand how it complies. The company should also try to work with the NAIC as well as the Actuarial Standards Board for the uniformity as well as the flexibility that we need so that we can avoid the inefficiencies that do exist.

Ms. Meltzer: In some cases with a new product, the particular design concept that's new will not be addressed by state regulation or state law, and here's where you see a divergence between the states and how they treat it. Some states are willing to look at it and say, "We don't address this so we don't regulate it." Other states will say, "We don't address this so we won't let you do it because we don't regulate it." The only thing that you can do there is try to justify your concept and show that it's a benefit to the consumer and will not adversely affect solvency. That's really a difficult argument to make with regulators for a number of reasons.

Here I have to say that I'm mostly very sympathetic towards regulators, because they do have a very tough time. They deal with understaffed departments, huge filings, and backlogs created when people are out sick. Sometimes the products that come in are very difficult, and they just can't spend 10 minutes on a filing and be confident that they let something go that's okay. It's really hard. Then, when they go ahead, they give comments.

In Florida, they say, "Answer these objections by this date or you're gone, and you have to start over." In many states, you'll get a letter, you'll wait six months to respond, and then the regulator picks it up and says, "Gee, what was I thinking when I did this? What was this all about?" Memory of that particular product, even if it's a new concept, is just gone, and they kind of have to start all over to look at your response because you've waited so long to respond to them.

One of the essential things to do to get things approved in a timely manner is to respond in a timely manner. Your compliance people might come to you, and say, "We need you to address this point." There might be only two items for the actuary, still you really have to put aside whatever else you're doing and spend the time to get the response to the state. I know that's a hard thing for you because there are other people who are beating you over the head for other things, but it's

just what I call "juggling." You must decide whether this is important enough for you to put your other things aside and spend the time to get it back to the state.

Mr. John A. Hartnedy: I'm going to try and score a couple of positive points with Ms. Meltzer. We're one of those states that if we don't have a law that prohibits it, you can do it. She smiled. I scored at least one point. I went to our filing people and suggested, "Why don't we consider accepting domiciliary state approval for our filings in the state of Arkansas?" On both the property and casualty and the life sides, I got an immediate response of, "You can't do that. " I asked, "Why not?"The reasons were that a number of companies will copy another company's filings, regularly and consistently. We'll get a filing from company ABC that hasn't changed the name from XYZ.

Although we'll get a compliance letter that says the form is in compliance, we get way too many that haven't bothered to look at our simple mandate laws, and Arkansas doesn't tend to have a lot of those. They just haven't bothered to get it in compliance. It's generally the same companies. If you get a filing from company X, you know they're going to be out of compliance. They're out of compliance every time they file, and they've omitted looking at the same thing every time. You write them back and say, "Change it," and they're very cooperative. They change it and send it in, and then it complies. Our people were not interested in doing that.

Do the majority of companies do a good job of filing, and could we accept domiciliary state approval? Yes, but too many don't. I'm not sure what you can do about that because you probably represent bigger companies and you send us good filings. If you're a consultant, there is something that you can do about it.

I'm going to go a little further with that. I was asked to review an actuarial memorandum. I don't review all of our filings unless there's a problem. That's about the only time that I get involved with our filings. There was a problem with this filing, because they tried to look at the actuarial memorandum and they couldn't make it match the filing. They couldn't make it match because it didn't match. It was a consulting actuary, so I gave him a call. He was complaining that the compliance officer had somehow mixed up the filings and sent in the wrong one, and it wasn't his problem. I informed him that, in my opinion, it was his problem. We disagreed, and I said, "That's fine, I'll just ask the ABCD." When I said that, he decided maybe it was his problem. I didn't tell him that I wasn't going to use his name, but I was going to ask the ABCD what it thought of that. He decided he would talk to the company.

He did call me back, and said he was glad I did that because the company was being pretty careless about their filings. I know it sounds like I'm disagreeing with the prior comments, but I must ask you actuaries, who are consultants, to get involved with the filing process. You need to know your memorandums are there, your professional signature is there, and that it does tie to what is being filed. I don't think that I'm alone in that opinion, so you need to look at it, and you need to

make sure that it's a decent filing, not just that your memorandum is accurate. For one thing, that'll improve the filings that are coming to us.
Now the other thing is this Gramm-Leach-Bliley Act that has been passed. For the first time in my 40-year career, and I've only been a regulator for three years, I think that we are going to do something seriously about getting more consistency in the states. The commissioners are committed. Those of us who are not at the commissioner level are not nearly as committed, but we do know who the bosses are.

I sat in a meeting with practically all of the commissioners and very few of the deputy staff. The commissioners agreed that they are going to get uniformity; they are going to get speed to market. In all my years in the industry, this is the first time I'd look anybody in the eye and tell you that I think the regulators will pull this off. You need to pay attention to how we want to do this because it's worth your time.

Five, 10, or 20 years ago, it wasn't worth your time. We weren't going to get it together in the regulator picture no matter what you said. It's different today. It's worth your time to look at how we want to do this and what input we need, because if you have a groundswell for an operation like the SOA or the Academy, you're going to make a difference. I feel very comfortable saying that. Give input on what's happening with Gramm-Leach-Bliley and speed to market. If you have an opinion and you have some ideas about how we can do that well, you're going to get a response now, whereas you might not have gotten one before.

I'm going to add one other thing. Somebody on this panel made a comment about federal and state regulations. Now that I'm a state regulator, I'm going to sound self-serving, but I worked for Golden Rule, a health company. Because of my experiences with Florida and Golden Rule, I now have pure respect for my friend David. I won't comment on what I thought of Florida and Golden Rule. I hope in fairness he won't comment on what he thought of me working for Golden Rule. Having been on the health side for part of my career, my comment is, you don't want federal regulation, and let me tell you why.

Suppose all the people in Kentucky were at the federal level. You would be out of business. You wouldn't be doing any health insurance in the whole country, if those were your federal regulators. If David and I give you too many problems, you have 49 other states to do business in. At least you can get to us.

When is the last time that you got to talk to a federal regulator, senator, or representative? If you're a smaller company and you do business in two or three states, think of what happens to them. They can at least come to us and we pay attention to them. We have 84 domestics in Arkansas. The majority of those are single-state companies. There isn't anybody at the federal level that's going to bother to listen to them. There might be one or two representatives, but that doesn't quite swing the vote in D.C.

I suggest that you think about that. Because of Gramm-Leach-Bliley, there's going to be a lot more coordination. You ought to think seriously about getting involved and supporting that, and pushing us to do a more coordinated job. That will be worthwhile for you. It will make your job easier, but I think you'll also benefit from it. These are just some comments from a regulator, who has spent most of his time in the industry.

Mr. Hippen: I sat through a session discussing Gramm-Leach-Bliley and the implications on the federal level, considering those who already have the attention of those at the federal level, and what's most likely to happen should we bridge from state to federal regulation. Actuaries are misguided if they think banks will set up federal regulation. This is the insurance industry.

I posed the question at that session, "What if the NAIC could be a federal regulatory body?" The consensus opinion seemed to be that there's no way that something as good as the NAIC will end up being a federal regulator. If you know the NAIC, you know that there are plenty of inefficiencies. There are plenty of tough things that take a long time to do, and this recent push is phenomenal in its speed and efficiency.

Ron Gebhardtsbauer started early on with the
PGBC. He talked about how the federal government developed a regulatory body. It didn't have any actuaries. It asked the accountants and the lawyers how to set things up. If you think the IRS or the FTC is going to set up a wonderful insurance regulatory body, think again. I think that there are plenty of inefficiencies in state regulation, without worsening them by going to federal regulation.

Also, if you get 30-45 approvals over time, or if you've proven that you're creating a product that consumers like, that doesn't hurt them, and that doesn't create company insolvency problems, then, even in a state as tough as New Jersey or Florida, it's going to be very hard for the regulators to resist for very long. You do have somebody you can talk to.

The part of my job that I enjoy the most is talking with a compliance person or especially an actuary because there are too few who get involved in the regulatory process. I try to explain to them how to comply with the law without hurting their marketing or their solvency. I love that. A federal regulator simply won't have time to do that. The SEC tried for a brief period with some products. For most they didn't have time, and now they have bowed out of even wanting to be the federal insurance regulators. It wouldn't be as good as they are.

Ms. Allen: With respect to the speed-to-market group, we have some real opportunity right now to have some input. There is another meeting that's going to be held on August 21 for the working group and interested parties. To get the material, visit the NAIC Web site, particularly if you have people that have attended the last meeting and have the pass code to get all of the minutes. Read them and look at them, and see what they're proposing, because I think we want to have input on the front end rather than try to resolve it on the back end. Take that

opportunity to visit, even attend the meeting if you can because, right now, they're really looking for strong industry input.

Mr. Ejaz Haroon: I have two questions about variable annuity filings. The first one is about the deemer statutes. There are some new deemer statutes in Massachusetts and New York. Apparently, there aren't a whole lot of companies that have used this statute in Massachusetts. Do you think it actually makes sense to have safety in numbers or to be the first one to go out and get killed?

The second thing was about the language of the contract versus the prospectus. For most variable annuities, contracts are very abbreviated, especially about things like annuitization, but if you read the same thing in the variable annuity prospectus, you see there's a lot more substance to it. Do you think it is very important to have a lot more information in the contract that mirrors what is already there in the prospectus, or do you think it is okay to have the state-mandated features in the contract and leave out all the details in the prospectus?

Ms. Meltzer: I think you have to look at what it is that your prospectus does that's not accommodated in the contract. The thing to keep in mind is that the contract is made up of guarantees. If what you put in the prospectus is not guaranteed, then you definitely don't want it in the contract. If you present it in the prospectus as guarantees, then you want it in the contract. Always keep in mind that if you have a disgruntled consumer who goes to court, what he or she is going to have in their hand is not necessarily the prospectus. What they're going to have in their hand is the contract, and that's what you have to defend.

Mr. Hippen: Let me just make a comment with regard to what I've seen in the industry, and with regard to regulation. I worked early in my career for a number of companies where I doubted seriously that they would ever get close to the edge of the law, and they didn't. I was continually amazed and wondered, "What on earth are these regulators worried about? No company would do those kinds of things. No actuary would allow those kinds of things to go on."

I worked as a regulator for a little while and saw some of those nasty things going on. I also had the misfortune of having a few people in companies I've worked for that didn't exactly try to do everything they were supposed to. They were trying to figure out how to get things by, whether or not they thought they were legal or appropriate, and the actuaries didn't always have the say. Actuaries were given the option of leaving if they didn't like what they saw.

Let me just give you a really quick example. Many companies, in their filings, want to have a little bit of flexibility, and so they'll bracket some of the items in the form, hoping to be able to change those at specific times for blocks of issues. But they don't always explain that that is what those brackets mean. In Florida we were a little bit picky about what it meant, but we really clamped down after a particular filing.

We got an application form in, which ordinarily (if it doesn't have strange questions) is not a big problem. The compliance person had bracketed all of the answers in the application. That seems like an ordinary enough thing to do. The analyst from the Florida department wrote back and said, "Please explain what you do with these brackets." The answer that came back was, "We only change the answers after the applicant has filled them in." We all laughed. We thought this was hilarious.

We said, "Oh, you know you've got a brand new compliance person that doesn't know, so go back and talk to the supervisor." We went back and talked to the supervisor, and the supervisor confirmed that the company's position was that if the agent thought that the answer wasn't quite right, he or she would change it before they inserted it into the application. It went directly from being a filing to being a market conduct case.

We don't dare assume because it gets us in trouble. Our favorites are the endorsements that have a bracket at the top left corner and a bracket in the bottom right corner, and nothing in the middle, and no explanation. It just says, "Please approve this endorsement, and we'll use it however we see fit."

Let me close with a comment that I've found to be very interesting. This is actually a comment that was made at the Enrolled Actuaries meeting, but it was from the President of the Conference of Consulting Actuaries, and I think it applies to each of us. "The quality of your work, in its technical aspect as well as its professional aspect (that is, how you conduct yourself), affects the reputation of our entire profession. Not only is it important to your reputation, but you're trading on my reputation as well." Therefore, I hope you will all get involved by reviewing and commenting on proposed standards as they're published and by utilizing our counseling and disciplinary processes. If you don't agree with them, say so and provide input. But be part of the profession. Work to change the profession and improve it where you see the opportunity to do so.