1996 VALUATION ACTUARY SYMPOSIUM PROCEEDINGS

SESSION 15

Small Company Issues

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SMALL COMPANY ISSUES

MS. NORMA Y. CHRISTOPHER: I am a vice president and chief actuary at a small company, Cotton States Life Insurance Company in Atlanta Georgia. In addition to those responsibilities, I'm responsible for the issue and underwriting departments, the policyholder service, and reinsurance and compliance, so I really have my hands full and it's very difficult to keep up with everything that's going on. If you're not a member of the Smaller Insurance Company Section, we would like for you to join because it's a great way to keep up with what's going on. We have a great newsletter called *small talk*, which usually has articles by our section members. I think you would really enjoy it.

Because this session is an open forum, we're going to have just short presentations, and we're going to encourage the audience to participate and give us your feedback on the emerging issues.

Our first speaker is Bob Dreyer. He is the senior vice president and chief actuary at Erie Family Life Insurance Company. He has been there for 13 years, and he's responsible for all the actuarial functions of the company. Before that, Bob was a valuation actuary at a large New York Mutual Company and also a consultant for several small and mid-sized companies. He chaired the organizing committee for the Smaller Insurance Company Section and was also on the first board of the section. He has been a frequent speaker at Society of Actuaries' meetings. He's going to be speaking on choosing a valuation system, which he recently did at his company. Maybe he did a lot of the homework that you won't have to do, and you can learn from what he has done.

Kevin Marti is going to speak on the illustration regulations and how they affect us. Kevin is the vice president of life administration and the chief life actuary at Westfield Life Insurance Company in Ohio. He and I have the same responsibilities in trying to wear many different hats. He is responsible for all the actuarial functions, issue and underwriting, administration, reinsurance and compliance. He also has his hands full. Bob will now discuss choosing a valuation system.

MR. ROBERT H. DREYER: This subject is a bit different from others we've had at previous symposia, but the planning committee is always looking for new suggestions. To be technically accurate, I have never had the experience of having to select a truly stand-alone valuation system, but I recently served in a consulting capacity to a task force at our company that was in the process of selecting an overall administration system to replace the home-grown system that was badly outdated. While I'll attempt to highlight the actuarial aspects of choosing a valuation system, my presentation will have broader applicability and is intended to help you in the process of selecting any prepackaged system.

When considering how to present this topic, I separated my ideas into four major categories: evaluation, investigation, selection and implementation. Those who are old enough to have had to take Latin in high school will remember the phrase, "Omnes Gallia, in tres partis divisa est." For you youngsters, this translates into, "All Gaul is divided into three parts." A phrase often used to comment on Methodist sermons and boring after-dinner talks. To set my self apart from those two categories, my presentation has four parts, and each of those is divided into four parts.

Let's start by talking about valuations. The first step in the process of evaluation is to determine your needs. Are you interested in only statutory valuations, or do you need tax and GAAP also? What product lines do you need to accommodate? Individual, group, life, health, disability income, pensions, variable products? With what other existing systems must you interface? What are your resources? Is your present hardware adequate, or will you need to purchase a new computer or peripheral equipment? Do you need personal computers or individual workstations? Do you have sufficient personnel in your data processing and actuarial department? Are your basic records readily convertible or will special handling be required?

How capable are your people in the data processing unit? Will additional training be needed for them to support the new system? Will you need outside support during or after the conversion? Does your actuarial staff have the expertise necessary to see the project through? What new techniques will have to be learned?

Finally, do you have any limitations? Are you dependent on consultants for either actuarial or systems support? Will there be a problem of compatibility with your existing systems or hardware? Are there budget or other constraints that could reduce the number of options you can consider?

This initial evaluation process is extremely important; just as in a baseball game, you have to get to first base before you can score a run. Your evaluation must be thorough and should be reduced to writing. You will need it, so that the vendor will understand what you are asking. You will need it when you have to judge competing proposals. You will need it when you design the implementation process. And finally, you will need it to evaluate your results.

Now let's move on to investigation. The first step in the investigation process is to identify as many potential vendors as you can. The April/May edition of the *Actuarial Digest* provides an extensive list of actuarial software and vendors each year. Other publications and word of mouth can also produce valuable leads.

Next you will need to develop some preliminary information concerning the vendors you have identified. Some of them, when contacted, may wish to make an immediate visit to your office, but for this preliminary stage, I think it's better handled by phone, fax, and mail. What you need to obtain is broad-based information as to how well each system and vendor might fit with yours. At this stage you don't want to be inundated with the dog and pony shows that offer little or no solution to the problem you have so carefully documented. You're looking for basic information at this point. Using that information, you'll be able to weed out the obvious misfits and arrive at the proverbial short list.

Now is the time for you to invite your carefully selected candidates to come to your office for a formal presentation of what they and their systems can do. Keep in mind that you are not just evaluating the system, but the vendor and its people also. These visits should be scheduled close enough together so the comparisons are fresh in your mind. But if they are too close, your audience's concentration may be impaired by overload.

During each presentation, you should develop a list of questions that the vendor can follow up on after the session. It may even be necessary to invite one or two of them back for a second meeting to get a more in-depth feel of the system's capabilities. If it is feasible, a hands-on demonstration can be extremely valuable.

The selection process begins with a list of the pros and cons of each system. These should be matched against your previously defined needs. Where there are shortcomings in a particular system, you will need to find out if a system modification is feasible or if there's some other way to meet your requirements. Don't overlook the possibility that a system might provide useful applications in addition to those in your original specifications. In a close call, this could be a deciding factor in your selection.

Other users can be an excellent source of information. All vendors are anxious to provide you with lists of satisfied customers -- whether or not there are unsatisfied customers is something you'll have to determine on your own. In my experience, most people are willing to talk very frankly about the systems they are using and any problems they may ave encountered. Time spent calling existing users can be most enlightening.

Find out all you can about the people you will be working with and the maintenance arrangements, including timeliness of upgrades to meet changing industry requirements. How committed is the vendor to this particular system? Does the vendor hold regular user group meetings? If so, it might be possible to arrange to attend one before your final decision.

In most cases a system is only as good as its support, so you may have to consider this question: if left on our own, could you provide adequate support for this system internally? Don't be shy about asking for and reviewing the vendor's financial statements. Their financial stability is critical to a long-term relationship.

Buying a major system is like getting married -- do everything you can to determine if you have a good fit with your partner. Many potential problems can be reduced to minor annoyances when you

can develop a synergy between you and your vendor. If purchasing a system is like getting married, then the contract you sign becomes your prenuptial agreement. It should include all the terms related to the purchase, installation, operation, maintenance, upgrading, and, if necessary, the possible termination of the marriage. Most important of all, it should be negotiable.

Invariably, particularly with the smaller companies, cost is a major consideration. If you accept the vendor's statement that the contract and price are nonnegotiable, then I'm interested in talking to you about the Brooklyn Bridge. No vendor in their right mind is going to spend time and money promoting a six figure system and then walk away from the deal because you need to renegotiate the price or some of the terms. The bigger the system and the more expensive the price tag, the more likely that you will be able to secure some concessions in terms and/or price.

In some cases, the vendor may seek a substantial payment prior to the time when the system is fully operational or request an early starting date for the maintenance fees, as we ran into once. The price may be a function of your current and future volumes of business.

In any of these examples, you may be able to agree on terms that benefit your needs, because they need that sale as much as you need the system. Sometimes the system that best fits your needs may be part of a larger system with features you cannot use. In this situation, it may be possible to go for a stripped down version of the total system where certain unneeded features are turned off and the price is reduced accordingly.

Another approach you might consider would be becoming a beta site. This may substantially reduce your lease costs, but there are headaches that can come with it. As a beta site, you will need to have a very experienced actuarial and data processing staff. You will be asked to contribute to this system, not just test and use it. You will need to have a lot of confidence in the vendor and negotiate the terms of the agreement very carefully. This is a viable approach if you are trying to get some of your ideas or special needs incorporated into the system. But don't attempt it solely for the purpose of saving money. Your time and labor costs may well exceed your dollar savings.

Now after the selection, the path to successful implementation starts with a selection of a single individual who will coordinate the entire project. Except for smaller systems, this is a full-time job and your candidate should be relieved of most, if not all, of their other responsibilities. This leader needs to have solid organizational and people skills, but does not necessarily have to be an actuarial, programming or data processing person.

Your coordinator's first responsibility will be to organize the team that will install the system, create the links with other systems and train other personnel in its usage. The team should have a nucleus of dedicated, full-time people, supplemented by part-time members in any specialty areas that need to be considered. They, in turn, should have direct access to an extensive support from the vendor. Clearly documented communications are a must if this project is to flow smoothly.

Once the team is established, the next priority should be the development of a plan of operation, including deadlines for various aspects of the project. The plan should have some flexibility because you cannot anticipate every problem in advance. On the other hand, any failure to meet the time schedule must be analyzed carefully as to its cause and its impact on future deadlines.

Senior management needs to monitor progress to know that the project is running smoothly and to anticipate the impact it may have on daily operations during the conversion and other activities. This is best accomplished through regular meetings with the project coordinator and reports from not only the coordinator, but also from other members.

Not to be overlooked in the monitoring process is the use of parallel runs as the project approaches fruition. No two valuation systems are going to turn out the exact same reserves, so it is important to analyze all differences. Similar concerns apply to any other system, if the system in question produces reports that impact your financials, as a valuation system does in particular. It would be advisable to get your auditors involved in this process at an early stage. They will need to be satisfied that any differences are justified, and if some of them are material, how will they be handled in your statements?

Finally, when your project is completed, celebrate, throw a party, make a big deal about "burning" the old system just like they used to do with a paid-off mortgage. Show your staff that their efforts were appreciated. In some instances a little gift for each of the participants might be appropriate, such as a t-shirt given out by one company.

MR. FRANCIS C. BERNARDI: I'm with United Presidential Life. About eight years ago, another actuary at a different company and I negotiated the purchase of a PC-based universal life valuation system. I'm not with that company anymore, but I know that they're happy with the purchase that they made. The comment I want to make is that, you may not know or the vendor may not have suggested that you're a beta test, but you may really be one. We were the third purchaser of their system, and we did a lot of checking once we got it. We uncovered quite a few errors that we felt were significant. So if you're going in and you're going to buy a system and there's only a couple of companies out there that purchased it, you may want to consider that as part of the negotiation. Part of the negotiation could be, if you test it and find errors, do you get a price break or something to that effect?

MR. DREYER: Very good point. You wake up the next morning and find out what you have, huh?

MR. PAUL J. SULEK: I have two comments. One is that it isn't always necessary to buy a system. Sometimes the third party administrator can do things better. A few years ago, I was working for a company that cut their cost in half by going to an outside third party administrator for their administration. They actually cut their cost by a factor of three and stopped running two years behind in upgrades to the system.

The second comment is that your system doesn't have to do everything. I have a few deficiency reserves in my reserves that I have to evaluate. My system does not calculate deficiency reserves, but I have a method of downloading those to a PC. I don't need to buy a valuation system that does deficiency reserves because I have another alternative way of doing it without having to go through the onerous method of manual extraction of data.

MR. DREYER: That's a very good point. Many systems these days have user exit ports that permit you to extract data from a certain phase of the system and put it into your own processing when the original system does not process for example, pay-out annuities. This is the sort of thing that can come out if you have your needs and desires in your original plan. When you start comparing that to the pros and cons of the systems that you're looking at, you're in a good position to know whether or not you can get this information out and feed it into another system.

MR. JAMES L. BERGIN: I've been involved in conversions of which I really was the lead, at least five times, in developing, evaluating, purchasing, and implementing the system. They all worked very well up to this last time. Last time the company did everything wrong, the opposite of what Bob said to do. They purchased a system that wasn't finished. They negotiate a long time on the contract, but the company was not in good financial shape at the time and no one checked that out. They originally dedicated two full-time people and within two months there was only one person working part-time on the system. So for all those reasons, we went through three years' worth of conversion.

MR. DREYER: These points are well taken and it's good to hear about these experiences. This is why I stress that when you find people who are using a system, take the time to talk with them. In at least one instance, we sent people out to another company that was using one of the systems. The other companies let our people come in for two days and see how the system was being used. This can be very valuable when you get to your selection process.

MR. JAMES N. VAN ELSEN: One thing we did on an earlier conversion in our negotiations with the vendor that some find useful is we managed to get the sales materials as an exhibit to the contract. That became very useful after negotiations. It can be something you overlook.

MR. DREYER: Do you also have a degree in law, Jim?

FROM THE FLOOR: Bob, would you care to share with us what your answer was? What did you buy? What type of system?

MR. DREYER: We were looking for a total administrative package, as I said. I'm not going to make any plugs. The final decision came down to a choice between a major mainframe and a major PC-driven AS400-type system. Neither vendor has been told our final decision yet, so I can't tell you which one won out, but we looked at both sides. We covered the waterfront, literally. We started looking for an administrative system roughly 14 months ago, and we have yet to sign the contract, but we hope to sign it this month.

MR. KEVIN A. MARTI: I think the mainframe Westfield bought before I came to work there took about fours to be implemented, if that has any effect on your decision. I'm going to speak about the Illustration Regulation. I'm going to give my small company perspective. To begin I will tell you a little bit about Westfield Life. We're a nearly 35-year-old life insurance affiliate of a nearly 150-year-old regional property/casualty parent company. The parent company is rated "A++" by A.M. Best, and the life company is rated "A+." We have over $6 billion of life insurance in force, primarily made up of universal life and term insurance, although we've introduced a couple of new whole life plans in the last year or two that are now accounting for about 10% of new sales. We have about $325 million in assets and about $53 million in surplus. The last $10 million came from our parent in June in a show of support for both our "A+" rating and for improved capitalization, largely needed in A.M. Best's eyes, for a smaller "A+" life insurance company. Just out of curiosity, are there any "A+" companies in the audience that would be smaller than Westfield Life? Anybody? That's kind of what I thought. We are one of the smallest life companies with an "A+" rating today.

MR. DREYER: We had to put up extra surplus too.

MR. MARTI: I don't have any illusion that the life company would be anything other than "A" if it wasn't for our parent company being "A++." We sort of cringe every time a storm goes through the Midwest because it might have an adverse affect on our parent company's rating, and ultimately on our rating.

I followed the development of the model illustration regulation fairly closely. I wrote letters to the National Association of Insurance Commissioners (NAIC) and articles in *small talk*, our Smaller

Insurance Company Section newsletter. I have spoken at four different meetings on the topic now, so as you might surmise, the regulation struck a few nerves in my case. The only positive outcome of the scrutiny that the regulation has undergone, between the time it was first drafted by the NAIC and its ultimate adoption, was the change to not require disclosure of the expense allocation method chosen on the illustration itself. The final regulation just requires us to communicate to our agents in some fashion what our expense allocation method is. Presumably this might happen through your illustration questionnaire from the America College of Life Underwriters (ACLU) if you do that, or perhaps through a company agent newsletter or for safety sake, maybe both.

I'm still troubled by the self-support test included in the model. I think there's a whiff of price fixing inherent in the expense requirements in there, especially from our small company perspective. We now have this additional $10 million of surplus, which will likely throw off enough excess investment income to cover our excess overhead expenses. Excess overhead expense will probably cause us to use the generally recognized expense table.

As I said, there are a number of different ways that I could rationalize why that doesn't make any sense. Our expense analysis or our self-support test is not completed at this time, but I understand our only hope for using full expense allocation is if the following occurs. The test requires a minimum zero profit margin at the end of 15 years, and we know that we price for a profit margin in our products, albeit with less than fully allocated overhead expenses in most cases. We have also used target surplus requirements in recent years' pricing exercises, as well as included inflation of maintenance expenses in those pricing efforts. These items, along with any conservatism that we might have in our mortality, interest, and lapse assumptions, could possibly be enough to offset the excess marketing and other overhead expenses that we have. We'll just have to go through the exercise and see whether that's true or not.

We have those excess costs because of our conscious decision to grow our life company and to support our parent property/casualty company in the operating territories that they operate in. We do that using salaried field marketing personnel, which probably makes all actuaries cringe. Our parent company doesn't use incentive compensation for their field marketing personnel, and, as a

result, we don't either. Not many life companies operate that way because it's certainly expensive to have fixed rather than variable and incentive-based costs. It's unfortunate, in my opinion, that the regulation can't recognize such special situations in a parent/subsidiary relationship.

My guess is that it will be advantageous to companies to adopt a portfolio-based approach to investment income, at least in the near term. For the foreseeable future, it appears that new money rates on investments will stay 100 or more basis points below what most companies' portfolio earnings rates are. If or when interest rates spike up significantly, companies may be forced to introduce a new money product to compete with other financial products at that point. But in the interim, it's a significant disadvantage, in my opinion, to be a new money company under this regulation.

Obviously, disclosure is still going to be an issue to be reckoned with, whether there's a model illustration regulation or not. My recommendation to our marketing people is going to be to formally declare a portfolio-based rate approach. As new money investment rates in the last couple years, on five-to-ten-year corporate bonds of reasonable quality dove down into the 6% range. We, like many other companies who were new money companies, continued to credit 5.75% or 6.25% on our products to keep our agents in the market, obviously based on the strength of our underlying portfolio-earned rate of 7.25-7.5%. We chose, as a company, not to lessen the quality of our investments to try to meet the market pressures that were coming to bear on new money companies. But I think the portfolio approach lends itself in this environment to a minimum spread type of approach, or a minimum-spread-to-stay-disciplined-type approach to managing the compliance that will be important for all of us during the course of time between our annual certifications of our disciplined scales.

I want to stress, as others have expressed, the nonguaranteed element disclaimer which says, "This illustration assumes that the currently illustrated nonguaranteed elements will continue unchanged for all years shown. This is not likely to occur and actual results may be more or less favorable than those shown."

While this statement may apply very well to participating whole life and interest-sensitive universal life type products, it is rarely applicable to term insurance coverages. Level premium term policies, whether the premium is guaranteed for the first level term or not, are highly unlikely to be changed based on my experience. Are there any companies here who have raised in-force term policies for any reason when they were beyond the guaranteed period? I really do not know any company that has done that. I don't know if there may be situations where experience may have justified that or not, but I think it's one thing if the regulation probably overstates the likelihood of a premium change in the case of a term insurance policy, where the statement may be totally appropriate for a universal life or a whole life policy.

Another area that we're still struggling with at Westfield Life is joint venture agreements. We have a 100% co-insurance arrangement on a second-to-die product which is issued on our paper utilizing the reinsurance company's product. We do this to bring our agents a product we would not normally be able to afford or have the expertise to develop internally. We, as a small company, obviously want to promote our own company though, so we did not want to take the approach of being a general agency for this company and writing the product on their paper. The various proposals the have been suggested to deal with this situation, from an illustration standpoint, are something along the following lines. Westfield's Board of Directors could appoint the reinsurer's illustration actuary for this product theoretically. Well, that's not likely to happen in my company. Our board is going to greet the "illustration actuary" concept with the same enthusiastic response as they greeted the valuation actuary concept -- with a ho hum. We go through the exercise every year to do our appointed actuary work, cash-flow testing, and so on. We generate a wonderful report, and I don't think our Board spends two minutes discussing it. I'm discouraged by that, but the fact of the matter is, we're a small life affiliate of a much lager property/casualty company, and they just don't understand the importance. I think they also have an incredible amount of trust in our investment officer, and hopefully myself, and feel that they don't need to be too worried about that matter. So I don't think appointing a person from another company as our illustration actuary for any products is going to fly with our board. Quite likely their response would be, stop selling the product.

Another suggestion that was made in this regard was to apply our experience factors to the reinsurer's product. I guess my answer to that is why would I do that if it's 100% reinsured? It's not my product. I didn't price it. I don't really have the experience backing the product. It's not my mortality risk at that point. It's not my investment experience that matters. It's not my lapse experience. I can't really rationalize why I should go through that exercise. My inclination is to opine on the reinsurance arrangement that we have in this situation and compare our concessions from the reinsurer with the commissions and other expenses that we have associated with this joint venture and to state reliance on the other company's illustration actuary for the values illustrated. I think I can defend this position on the basis of the analogy of affiliated companies combining their data for experience factors for similar products issued in similar markets. In our situation, it just happens that the ten companies that are selling the same second-to-die product are not affiliated in the same fashion as subsidiaries; they're affiliated as product marketers.

Our intention at Westfield is to implement the model regulation formats in all our active states in January. We're licensed in 46 states, but we're really only active in about 15 or 16. North Dakota, Iowa, Wisconsin, and maybe Pennsylvania are the ones that are likely to have this in place. The real question will be, if we're going to implement it in all our active states, have they adopted the regulation or not? We think it will be more trouble to try to distinguish between the two types of illustrations than to do it everywhere. I was pleasantly surprised that our marketing folks agreed with that.

Whether or not we will ultimately have the will to enforce the signature requirements and so on, in these states where the regulation has not been implemented yet, remains to be seen.

In the infamous words of Forrest Gump, "That's all I have to say about that." But I would be happy to have some dialogue with you about these or any other implementation issues you see on the model illustration regulation.

MR. DREYER: Kevin, we took the opposite track on implementation, and we are only going to implement on a state-by-state basis as it comes about. There's the concern of the extra burden it

places on property/casualty agents to learn this stuff and understand what they're signing, get them to sign it, and turn it in and all.

MR. MARTI: I guess the distinction that Westfield might have is that, although we utilize the property/casualty agency plant, our primary focus is to place career life producers in those property/ casualty agencies. So our expectation is that they're going to be exposed to this from other companies and they're fully aware of where this is heading, somewhere down the road. But we certainly do get a fair amount of our business from property/casualty agents.

MR. PETER G. HENDEE: Just for the record, we do have a term policy in our buy-sell agreement which states that the current rates being charged are higher than the current rates listed in the policy. so there is at least one company somewhere that made that change.

MS. DEBORAH K. SLOAN: With respect to the last question regarding what companies are doing what, can we do an informal survey as far as how many companies are going to try and go for all states? We have decided we're going to try and put it in. Number one, my Information Technology (IT) area says they can't support two different illustration systems. It's hard enough to make the change for one. We're also looking at the market conduct aspect. If we're going with the market conduct, we're working through all of those issues; we're also looking at whether we can, with a clear conscience, say, "Hey, we're expecting full disclosure in some states, but from a market conduct standpoint, it's okay not to do it in other states." How many people are going to make it across the board if they have to put it in for some states? How many are going state-by-state as it comes in? It looks like about half and half.

MR. MARTI: Some are undecided. How many of you are still refusing to accept that we're going to have this?

MS. SLOAN: I don't know what will happen when I get down at the end of the year. Marketing has kind of signed on right now. When they get down and start hearing protests from the field, I

don't know what kind of pressure we are going to have. Backpedalling on that decision could be another matter.

MR. MARTI: The one thing I will say is states that are likely to adopt are not as important to us as the ones that have not stepped up and said they were going to adopt it, so I'll be interested to see if the marketing people change their tune when it comes right down to it in November and December. When we start planning meetings to introduce this and tell them that effective January 1st, this is the way it's going to work, it'll be interesting to see if we're able to hold the line across the board like we hope to.

MR. DREYER: I think another aspect of this, Kevin, is I'm hearing horror stories about companies that are having to modify their plans because they can't illustrate or get as aggressive on their illustrations because of their disciplined current scale (DCS). I would imagine a company that's faced with a necessity of changing its plan or changing its illustration is more apt to go on a state-by-state basis. Product surveys, like A.M. Best Universal Life Survey and various other surveys will come out from time to time. When they come out we'll pick out a representative group of 20 or 30 companies that we believe are our competitors. I have yet to find a survey where we're anything other than middle of the road on any measure in any of those surveys. To think that we can go through this exercise and come to the point where we can't even illustrate what we're currently illustrating is really dismaying to me.

MR. PAUL F. WHARRAM: You talked about three different options: state by state, all states, and don't know yet. Here's a fourth one that I don't believe we will in fact implement, but we have talked about it. That was simply to stop selling in those states that became effective January 1st, because they are in fact not our major states. Then later on, when we're ready, we can get back into those states. I don't think that'll happen, but it's an option we've talked about.

MR. MARTI: I've never met a marketing person yet who was willing to give up on any agent, or to have two weeks where they couldn't be selling something that we had, so I guess I have a hard time relating to that.

MS. DONNA R. CLAIRE: Just one question on adopting an old state and this is on Actuaries Online. Someone actually did a survey saying we're planning on implementing it in all states; is this okay? The states that have already adopted said yes. Several of them said yes, even though they haven't adopted. Some say we have no clue and some actually at this point have said no, because they have different current requirements. So it's something you really have to look into for each state.

MR. MARTI: Good point. There's one other question that came up at another session. It pertains to how we do a statement of policy cost and benefit information page, right behind the specifications page when we issue a policy. It came to mind that when going through and having these five- or six-page illustrations with the midpoint scales and so on and all the signatures and everything, it might make a lot of sense to replace the statement of policy cost and benefit information in the policy with the signed document. I don't know if anybody has had any discussions with state insurance departments. Maybe Tom Foley could speak to that. We talk about keeping these things on file until three years after the policy is lapsed, but I really think it would be a good step to make these part of the policy or attach them to the policy.

MR. THOMAS C. FOLEY: I am with the North Dakota Department of Insurance. I was vice chair of the NAIC working group that put this together. I hesitate to get up here with the animosity I sense.

MR. MARTI: Tom, it's not near as bad as it was last year. I think the resignation is starting to set in!

MR. FOLEY: That was an interesting session we had in October, wasn't it? If I understand you, you're not talking about the policy summary that goes along with the Buyers' Guide.

FROM THE FLOOR: I'm not sure.

MS. CLAIRE: I am.

MR. MARTI: The statement of policy cost and benefit information typically show projected values at various points in time.

MR. FOLEY: The working group decided to revise the Buyers' Guide, which is done right now. The cost indices information generally is being removed from the Buyers' Guide for the following reason. What we decided is, if a company decides for a policy form that they're going to illustrate that policy form, then the basic illustration can serve as the policy summary, relative to the Buyers' Guide. Now that removes the cost indices because there aren't any cost indices in the basic illustration.

If it's a policy form that you've decided that you're not going to illustrate, then you would need to continue to provide the policy summary, but use guarantees only. Because that way it would be tremendously inconsistent to turn around and say we're not going to illustrate this and then provide a policy summary that has nonguaranteed elements in it.

With regard to the indices, you may be aware of the *Money* magazine article that came out within the last month, lambasting the insurance industry and regulators for all kinds of reasons. One reason is that we don't listen to consumers. So now we are considering additional cost indices. I think that it's going to turn out that the revised Buyers' Guide will include reference to cost indices, whether it includes any descriptions, I'm not sure. I would doubt it, but we haven't finalized that. In fact, we'll be meeting in Alaska in three weeks to talk about that. So basically where we are right now is, if it's a form that you choose to illustrate, then the policy summary is satisfied by the basic illustration.

MR. MARTI: Is that a state-by-state decision, though?

MR. FOLEY: Well it is in a sense. The working group sent a letter to all commissioners and strongly encouraged them to adopt that. Now I've talked to two or three states, subsequent to that, which seem to be going along with that. You're absolutely right; it has to be state by state, because the model is state by state.

MR. MARTI: Tom, do you know anything about the Texas situation?

MR. FOLEY: I can tell you that the working group and the NAIC is bringing every degree of pressure that it can, and I want to emphasize that it can, because we are 50 independent insured states and there is just so much that we can do. We have talked to the Texas people privately. We have talked to them in every way that we can. We feel very strongly that if we're going to be able to decide whether the model that we've put together for this whole concept works, it needs to be universally adopted, and we need to give the industry a couple of years to see if indeed they will clean up their act in a certain sense. If they will then I don't think we need to do any more. On the other hand, if we have maverick states that go in different directions, then it's going to be much more difficult for us to judge whether this works or not. So that's our primary pitch. At this point, I don't have any inside information, but maybe Donna does.

MS. CLAIRE: There is an American Academy of Actuaries' committee that has been working closely with the Texas Department on the actuarial issues. They actually have released another draft which has changed from the draft that most of you have probably seen. On the good news side, they have at least gone to the point where the disciplined current scale (DCS) will be the same. So from an actuarial point of view, they have accepted the fact that if they come up with a different definition, nobody, including the ASB, is going to come up with anything to support it. At least from an actuarial point of view, the DCS is probably the one that they are going to propose. However, in the draft, there is still substantial differences in terms of implementation, and what has to be shown on the illustration, per se.

MR. JOSEPH E. BRENNAN: I'm going to address this question to the panel or the audience. The Model Illustration Regulation, in terms of what actually gets illustrated, was intended to be geared towards the higher face amount vanishing premium life, universal life, and things like that. However it also made exceptions for very small face amount policies, debit insurance, and things like that.

There's a piece in the middle that I'm going to call kitchen counter sales, which seemed to have been left out. Smaller companies in particular know these agents. They're agents that go out and are

selling anywhere from $25,000 to $100,000 face amounts. They're doing it over the kitchen table. They're usually showing up with some kind of information about the policy. They might be selling an indeterminate premium product, which the company wants to use so it doesn't get stuck with too many deficiency reserves. But the agent is not coming out with a computer to give out the illustrations. In fact, most of the agents don't have computers. They'll often come with information at the end of ten years and then at age 65. Agents will give some kind of a written illustration to the person, basically filling in a few numbers and he'll make the sale. Then the person would get the policy in the mail.

We believe that there's nothing in the model illustration that would allow this anymore. Either the agent has to show nothing or the agent is going to have to show the complete computer illustration. Is there anybody who ha been through this and has any answers in terms of what you need to do?

MR. MARTI: I think what you said is basically right. It's marketed with or without an illustration. If it's marketed with an illustration, and it has nonguaranteed elements, once you get above $10,000, it's required to be shown with an illustration that complies with the full package. But I guess I would say this too. We sell a lot of policies, between $25,000 and $100,000, as well as many larger than that amount. So I guess we weren't surprised when the requirements were made applicable to most of the policies that we sell.

MR. GREGORY D. JACOBS: Here' two absurd responses to what I consider an absurd regulation. One is real and one is hypothetical. The real one comes first. Agents in Australia and in Europe (I'm not sure about Canada) don't illustrate. They offer prospectuses, much like exists when selling stock. The footnote at the bottom says past history is no indication of future results. I work with the marketing people and I would propose to us all that maybe the right solution is not to illustrate anything, but to offer the product, offer a document about what the company is about (explaining management philosophy, past history, and future history, which is no guarantee). That's how you should sell products in the future. That's idea number one and that's the real one.

The other idea is somewhat absurd, but if you think about it, you could maybe make an argument that it makes some sense, and that is, guarantee everything. With the way some of the reserve requirements like XXX and GGG are going, we're continually faced with higher and higher reserve levels. I'm not so sure it's a terrible stretch of the imagination to take it all the way to the extreme by offering guarantees. We can still pay excess interest. We say that we will pay excess interest, but we won't illustrate it. We get a tax deduction, and obviously it's going to hurt our capital. It's somewhat absurd, but again, it deals with the absurdity of the situation we're in.

MR. MARTI: Tom could speak to this, but I don't think that regulators would object to not using illustrations at all or to showing past history and so on. I think some of the early development of the model regulation centered on ideas like only showing guarantees or only showing past history. I think the industry brought the whole process back around to where we ended up, more so than the regulators did.