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THE NEW MODEL VALUATION AND NONFORFEITURE LAWS

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(Concluded from November and December issues)

More on Statutory Maximum Valuation Interest Rates

The second of these three articles outlined the new approach to statutory maximum interest rates, and gave a few figures for traditional life insurance forms. The following is a more complete table:

Maximum Valuation Interest Rates for 1981

Policy Form	*Longest Period That Policy Can Remain In Force*	*Maximum Rate or Range of Rates (see Note 1)*
Life Insurance	More than 20 Yrs.	5.00%
	11 - 20 Years	5.75
	10 Yrs. or Less	6.00
	Guarantee Duration (Yrs.)	
Immediate Annuities	All	11.50
Deferred Annuities & Guaranteed Interest Contracts Valued By Issue Year	More than 20 Yrs.	5.50 - 7.75
	11 - 20 Years	6.25 - 10.00
	6 - 10 Years	8.25 - 11.50
	5 Yrs. or Less	8.25 - 12.00
Deferred Annuities & Guaranteed Interest Contracts Valued on Change-in-Fund Basis (see Note 2)	More than 20 Yrs.	7.25 - 10.00
	11 - 20 Years	8.25 - 12.00
	6 - 10 Years	9.00 - 13.25
	5 Yrs. or Less	9.00 - 13.75

Note 1: Precise values within the rate ranges shown depend upon the extent of the interest guarantee and the conditions under which funds are withdrawable.

Note 2: The change-in-fund basis values the original amount deposited at the interest rate in effect when it was deposited; all changes to the fund thereafter, including interest on the original deposit, are valued at the rates in effect when they occurred.

Maximum Valuation Interest Rates for 1982

Life Insurance	More than 20 Yrs.	5.50%
	11 - 20 Years	6.25
	10 Yrs. or Less	6.75

Because they depend upon averages of market interest rates that extend to June 1981, interest rates for 1982 that apply to annuities and guaranteed interest contracts are not yet known. They will be promulgated by NAIC about August 1982, and published either in NAIC's "Journal of Insurance Regulation" or the next NAIC Proceedings.

Formula for Minimum Nonforfeiture Benefits

The formula for the adjusted premium has been changed in several ways:

- Removing the old formula's circularity; its definition of the adjusted premium included some percentages of the adjusted premium itself. The new percentage-of-premium factor is a straightforward 125% of the net level premium.
- Reducing the amount-of-insurance factor from 2% to 1%.
- Redefining the equivalent uniform amount on nonlevel coverages as the amount averaged over the first ten policy years only.
- Limiting the nonforfeiture net level premium (rather than the adjusted premium) to 4% of the amount of insurance.
- Exempting from requirement for nonforfeiture values (i) any plan whose calculated minimum cash value never exceeds 2½% of the amount of insurance, and (ii) level term for 20 years or less, expiring before age 71, provided there is no accompanying guaranteed endowment or nonforfeiture benefit.

For descriptions of this new formula's development, see Charles F. B. Richardson's paper (*TSA XXIX*, 209) and the Unruh Committee report (*TSA XXVII*, 549).

High Cash Value Plans

The matter of setting up adequate reserves for high cash value policies demands more attention than it has been given in the past, particularly now that direct linkage between valuation and nonforfeiture interest rates has been removed and deficiency reserve requirements have been lightened. The premiums for these policies are highly competitive, their gross premiums frequently being less than the valuation net premiums; if not adequately reserved for, serious solvency problems threaten at later policy durations when these policies may generate net cash outflow and drain on surplus.

The statute setting forth the Commissioners' Reserve Valuation Method requires that the reserve be the excess, if any, of the present value of future guaranteed benefits over the present value of future modified net premiums. Cash values, of course, are guaranteed benefits, so reserves must be established for cash values that exceed regular reserves, a condition that occurs not infrequently.

The NAIC Technical Staff is drafting a guideline on this subject to be brought up for discussion at the June 1982 NAIC meeting, and for adoption at the December 1982 meeting.

A related question is whether traditional insurance plans should be allowed to provide nonguaranteed cash values on top of guaranteed values, a practice that is developing in some universal life plans. This is being studied by the Technical Staff and its advisory committee.

Fitting Policy Values To The New Law

For several years companies will be writing business in states with varying degrees of enactment of the new legislation. Those who choose not to wait until the new law has been adopted throughout their territory will be faced with

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New Model Valuation

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some minimum paid-up values and extended term periods higher than those now required. To keep the resulting filing of new forms to a minimum, companies may resort to policy forms under which only the rate and value pages need to be revised as the requirements change.

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To sum up the three articles on this subject: I believe that these new laws will be found to serve the public effectively in their flexibility and in their safeguarding of company solvency, and likewise in the reasonableness of the withdrawal benefits whose minimums they prescribe. □

A Chance To Acquaint Yourself With Modern Risk Theory

Any member who wants a two-day course built upon the recently announced text material on Risk Theory — see "New Risk Theory Study Note Signals Change," front page of our December 1981 issue—is invited to enroll, while space is available, in one of several seminars to be held in March.

Response by Part 5A students has been so strong that sessions are scheduled for numerous cities, probably in one convenient to you. If this may interest you, ask Linden N. Cole at the Society office for particulars.

Response to Inflation

(*Continued from page 1*)

Current persistent inflation in the U.K. is peculiar to this era in British history. During John Maynard Keynes' heyday (1919-46) Britain had experienced remarkably stable prices amidst generally high unemployment; hence controlling unemployment was his primary concern. He thought employment would respond to government taxation and expenditure policies; probably he was unaware that inflationary gaps might simultaneously cause unemployment, productive stagnancy and price increases.

Inflation's most damaging effect is that it redistributes income haphazardly, taking it from those who can't protect themselves from price increases and giving it to those who can.

Many economists have expected persistently low unemployment to go along with high inflation and rapid growth in the money supply. But today's experience having shown the reverse to be usually true, the conclusion often reached is that the money supply must be reduced to cure inflation; slowing its growth results in higher unemployment unless the private sector reacts by promptly moderating wage demands and price increases.

British price levels increased explosively in 1972 following one of the highest fiscal deficits in its history occurring at an "inflationary gap" point. Blaming this on high wage settlements, the government imposed strict wage and price controls. Unions reacted with demands aimed at restoring wages to their previous level in real terms; the results were crippling strikes in key industries, power cuts, social unrest, the calling of a general election and the government's fall. The incoming Labour government surrender to the strikers' demands; the income policy collapsed; lost output and social stress were enormous, yet inflation was not controlled.

The Prime Minister's View

Mrs. Thatcher, coming to power in 1979, adopted a different economic strategy. She may have assumed that because wage and price controls had failed before, they would be expected not to work, hence inflation would resume as soon as they were lifted. Her approach was to reduce aggregate demand by contracting the money supply and by other monetary and fiscal measures.

She said she was committed—to reducing the rate of growth of the money supply—to creating conditions for a sustainable economic growth—to strengthening incentives by allowing people to keep more of what they earn—to enlarging individual freedom of choice by reducing the role of the State—to reducing the burden of financing the public sector so as to leave room for commerce and industry to prosper—and to promoting a proper sense of responsibility in those who take part in collective bargaining.

Her primary initial monetary measure was to keep high the interest rate at which the (Central) Bank of England makes advances to the chartered banks, with the twin objectives of discouraging borrowing by businesses and individuals and reducing profits so that management would surrender less easily to unreasonable wage demands. Her fiscal measure was to reduce income taxes, making up the resulting loss in tax revenue by increasing the rate for the national sales tax (VAT) and employers' social security contributions; her hope here was to confront taxpayers with the choice between contributing via VAT in spending their tax savings or else increasing their own savings. And she undertook to reduce public expenditures wherever possible.

The Story So Far

Up to her announcement of the 1981-82 budget in March 1981 the effects of Mrs. Thatcher's policies were:

- unemployment at an unusually high level and still growing;
- increases in business bankruptcies and near bankruptcies, which she has alleviated in a small way by reducing the minimum lending rate from 14% to 12% and granting enormous subsidies to several essential industries;
- moderation in wage settlements as labour and management both realized that profit margins were too slim to risk unreasonable increases;
- inflation rate moving from 12% when she took office to 23% in April 1980, then down to 13% in March 1981;
- 20% 1980-81 growth in the money supply, much higher than the 13% when she took office and than her 7% to 11% goal (which has caused her to impose tax increases whose burden will be mainly on the consumer rather than on the generally financially weak industry);
- and a strong pound sterling, attributable partly to self-sufficiency in oil.

It will be interesting to see whether, until election day in 1984, the Iron Lady can continue to convince a growingly rebellious cabinet and hundreds of leading British economists that her austerity program will achieve her goals, and what further pragmatic strategy changes, if any, she will make. □