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Federal statistics: The Bureau of Economic Analysis

by Allan H. Young

What is your economic IQ? Try answering these questions:

- Is direct investment of U.S. corporations in foreign countries larger or smaller than direct investment of foreign corporations in the United States?
- From 1980 to 1987, did federal tax receipts as a percentage of GNP increase, decrease, or stay about the same?
- Has the 1970s pattern of more rapid growth in nonmetropolitan counties than in metropolitan counties continued in the 1980s?

The answers can be found in the economic intelligence prepared by the U.S. Bureau of Economic Analysis (BEA) (and at the end of this article).

Information from BEA is necessary for most types of economic analysis, whether their focus is international, national, or regional. This article describes BEA's program, tells how to obtain BEA's outputs, and looks at some issues BEA faces.

BEA's program
BEA's work centers on the preparation of the nation's economic accounts. These accounts, designed as a consistent and comprehensive record of the nation's economic transactions, portray what is going on in the economy. A brief description of these accounts follows.

International economic accounts show the transactions of U.S. residents with residents of other countries. These accounts, often referred to as the balance of payments

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Two approaches to life insurance cost illustrations

by William A. Stoltzmann and Stephen H. Frankel

(Ed. note: At the June meeting of the National Association of Insurance Commissioners, the American Council of Life Insurance proposed that a "range" approach to insurance and annuity sales illustrations be considered [and adopted] by the NAIC. This approach would allow agents to illustrate at greater than current interest assumptions if they also show an illustration at correspondingly less than current interest assumptions. The maximum range would be 2% above and below current.

There has been debate on this "range" approach. Here we give a "pro" view and a "con" view.)

Stoltzmann, for the "range" approach:
In December 1987 the NAIC adopted a model regulation that would limit illustrations of policy benefits to those provided by the company's current scales for interest rates, expenses charges and mortality costs. This step was a response to concerns about unrealistically favorable illustrations of policy values using high interest rates over long periods. As the following discussion indicates, the policy's expense levels and mortality costs can also have a significant effect on the values being illustrated. Because information about those

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Frankel, for the current-scale limit:
Sales illustrations should be limited to assumptions that are less than or equal to current. In my opinion, a current scale limitation provides discipline and structure because current scale generally represents what is actually being paid today. Any other approach is arbitrary and will eliminate much of the discipline and structure. As a result, agents will tend to emphasize the highest values their company allows to be shown. Abuses can and will occur. Policyowner complaints and lawsuits, which are already on the rise due to declining interest rates and loss of policy loan

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Stoltzmann cont'd

factors does not normally appear in illustrations and because variations in these factors have little, if any, meaning for the average consumer, there is little industry opposition to the NAIC's position that those factors should be limited to current scales.

The NAIC proposal to limit an illustration to the company's current interest rate, however, has generated much concern. Of all the factors affecting the policy's value, the interest rate is most prominently displayed in the typical illustration. In an increasingly interest-rate-conscious society, most consumers, and many sales people, first look at the interest rate to see whether the product is competitive. Because of the complexity of today's life insurance policies, focusing on and limiting illustrations to the policy's current interest rate gives undue and potentially misleading emphasis to this one factor.

The most serious problem presented by focusing on current interest rates was highlighted in a March 28, 1988, *Wall Street Journal* article entitled "Lagging Returns on Universal Life Plans Create Disenchantment Among Holders." Comments in that article referred to illustrations based on companies' current interest rates. The article said, "With interest rates on the policies down to 8% and 9% from 12% or more in the early 1980s, some universal life policies aren't living up to the aggressive projections of savings growth that were used to sell them. And it appears that many early buyers of the coverage didn't understand that the projected results weren't guaranteed and that lower interest rates could require them to pay more or accept reduced benefits."

In focusing on the interest rate, we unduly emphasize a factor that, when viewed over the life of the contract, is an inaccurate representation of what the contract will actually provide. The only thing I can guarantee to our customers concerning an illustration based on our current rate of 8.50% is that 60 years from now, or five years, or even one year from now, the values they will see in their contract will be different from those shown in the illustration. By concentrating on a company's current interest rate, we mislead our customers into believing that the contract will in fact provide these values.

Our industry risks the loss of the public's confidence. Our attention ought to focus on the credibility of the information we provide to our customers, and not on the current interest rate that we may be crediting. After all, a life insurance policy illustration is supposed to give the customer some represented values over periods of 20, 40 or even 60 years. It hardly seems realistic that the interest rate credited by a company today, whether that rate is 5%, 10%, or 15%, will bear any reasonable relationship to the values that a customer might expect his contract to have 20 or 60 years down the road.

This is particularly true in periods of interest rate peaks or troughs. If we were in a period of high interest rates, I doubt that anyone would say that illustrations showing values at 15% over a period of 60 years would produce reasonable values. However, that is exactly what the NAIC current-rate limitation would require companies and their agents to illustrate. Here's an example of the seriousness of this issue: A universal life illustration at 15% on a 20-year-old male with a $10,000 premium payment provides cash value of $4,179,000 at age 65. At a more realistic long-term rate of 8%, the cash value of that policy at age 65 would be $223,000.

Under the current NAIC model rule, a company could illustrate high interest rates of 12% for up to 60 years if it credited that rate in the first year, even if it planned to significantly drop the renewal rate to a more realistic 6%, 7%, or 8%. However, a company that had responsibly and prudently dropped its current rates to more accurately reflect its current investment yields would be limited to illustrating values at those lower rates. It seems axiomatic that an industry regulation should not hamstring the most prudent, responsible companies.

Another problem with the current interest rate limitation is that it places companies in a competitively favorable or unfavorable position, based solely on the interest-crediting procedures that they use. A company using a portfolio method for crediting interest may be able to illustrate higher current interest rates than can a company using a new-money approach as interest rates decline. Conversely, as interest rates rise, a new-money company may be able to

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Stoltzman cont'd

show a higher current rate than can a portfolio company.

The focus on the policy's current interest rate masks the far more important issues of how a company treats its customers over the long term and whether the company has the financial resources to provide the benefits that are illustrated. To me, a reasonable restriction on illustrations (such as the range approach provides), coupled with a far more prominent disclosure of the need to examine the company's financial situation and renewal rate history, will be a significant advance over the current-rate limitation.

The basic purpose of the range concept is to put illustrations in perspective, as examples of how a product may perform, rather than serving as benchmarks of how a product will perform. In addition, it allows a prudent company to be competitive with one that is artificially holding up its first-year interest rate. When coupled with an additional disclosure indicating that the rates and other charges and expenses of the contract are variable and need to be examined in light of the company's financial condition and history of setting renewal rates, this approach will go a long way in helping customers evaluate the product they are considering.

Frankel cont'd

interest deductibility, could increase even further. Finally, unwanted regulations could be imposed on us by a variety of government bodies.

My specific concerns about the range approach are as follows:

1. Credibility
Proponents of the range approach argue that it will give more credibility than the current. In its most popular sense, "credibility" conjures up the notion of likelihood. That is, "the actual values are likely to fall within this range." However, we are talking about illustrations, not projections. Since illustrations should educate and not project, credibility is not really an issue. As a result, the argument that the range approach provides credibility does not persuade me. First, credibility and illustrations should not go hand in hand. Second, it's wrong to create the perception in the buyer's mind that there is a strong likelihood that the values will fall within the range.

2. Education
Proponents of the range approach argue that it can be educational with respect to such items as differences in interest crediting methods or the internal working of the policy. If that is true, and I concede it may be, modelling illustrations on different sets of assumptions that are all less than or equal to current is more than adequate.

3. Range "high" point
I am concerned that the highest value of the range will be emphasized (or the only one shown) to the prospective buyer. These artificially inflated values, if abused in sales presentations, could cause policyowner disappointment in the future.

4. Range "low" point
If the low end is also emphasized, it could be interpreted as a guarantee. The range then becomes a guaranteed set of boundaries.

5. Manipulation
Suppose "Company A" has a current rate of 8% and Company B has a current rate of 7%. Under the proposal, the allowable ranges will be 6-10% and 5-9%, respectively. Is it not likely that an agent of Company B will then argue that the high end of the range is suitable for his company, but only the middle is appropriate for the other company due to different investment policies? Have we merely created more opportunity for manipulation?

6. Confusion
Will agents and policyowners be able to deal with the additional scenarios? They already are inundated with enough values using guaranteed and current scenarios. Now agents will be showing at least two more.

7. Other factors
The range is based only on the interest rate. Should we also allow mortality and expense factors in order to be complete? In addition, by focusing only on the interest rate, will the range approach lead to even greater interest-rate competition than today? This could give impetus to unfavorable tax legislation.

But enough about illustrations. Whether limited to current assumptions or not, they are really quite inadequate for the purposes of comparing products of different companies. Rather, we should broaden our view. In any competitive sales situation, the prospect should review the following items for each product before purchasing:

- Company
  - Image
  - Mission statement
  - Financial strength
  - Treatment of existing and new policyowners
- Contract
  - Provisions
  - Benefits
  - Definitions (how liberal?)
- Service
  - Commitment of company and agent
  - Competency of company and agent
  - Claims philosophy
- Cost
  - Guarantees
  - Histories
  - Illustrations

As you can see, although actual cost experience should not be ignored, it is certainly not the only factor to be considered in the buying decision. If more sales were based on all four factors, we would see a decline in policyholder complaints.

To summarize, I would like to make five points:

1. We need discipline in our sales illustrations. Otherwise, outside authorities are likely to mandate laws we may not like.

2. Even though illustrated values based on current assumptions most probably will not be paid, they still represent more discipline than above-scale illustrations.

3. The range approach conjures up the notion that results will fall within a specific range. This notion of credibility is not correct.

4. Using the current-scale limitation with flexibility to illustrate downward can show the internal workings of a product and the effect of different investment policies. A range approach that allows above-scale illustrations adds nothing.

5. In competitive situations, illustration comparison is useless. What is really needed is a "broad" approach, which compares company, contract, client service, and cost.

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