The Actuary

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Here To Stay?

(Continued)

On the first of these, the IRS ruled that such death benefits are to be treated as life insurance proceeds, but cautioned that the cash value must be "equivalent to the cash value or reserve under a more traditional life insurance policy" and not be a "side fund" variety of cash value. The second ruling conceded that term riders too are life insurance proceeds under the section cited. And on the third question, the IRS concluded that the policyholder would not be in constructive receipt of credited interest prior to surrender. Although presumably indicative of the Service's general feelings, a private letter ruling is directed only to the taxpayer requesting it, and may not be used by others or cited as a precedent.

Company Federal Income Tax

There have been no official IRS pronouncements on treatment of Universal Life for company tax, the major question being how excess interest credited to reserves and cash values is to be handled. A consortium of life companies happens just now to be seeking IRS's answer to this excess interest question for annuity contracts; that emerging ruling should indicate the rule that will apply to Universal Life and other products that involve life contingencies. Meanwhile, at least one company has requested a ruling on this point.

State Insurance Departments

In general, state regulators are displaying willingness to accept innovative products that benefit the public. Universal life has, though, encountered difficulties in seven states. And many department approvals are subject to close subsequent monitoring related to company solvency, disclosure to prospects and policyholders, and compliance with valuation and non-forfeiture statutes.

Because of this product's flexibility, tables of non-forfeiture values in the policy aren't much help. Nevertheless, some departments do require them. Since premiums, cost of insurance rates and interest credits all vary, the best and usual arrangement is to furnish non-forfeiture value specifics to policyholders annually. Making the calculations retrospectively, the product can be shown to be in compliance with current valuation and non-forfeiture laws.

As to solvency, insurance departments are most worried about products that tie the interest rate to an outside index such as, to mention one example, the 91-Day U.S. Treasury Bill Discount Rate. Their main concern is whether investments underlying such a promise will satisfactorily match the index in both size and period to maturity. Proper matching can be demonstrated by earmarking the assets that support the reserves—either by earmarking specific assets in the company's General Account or by forming a separate company to write only Universal Life Products.

The Challenge Ahead

The challenge our industry faces was brought on by outside economic and social forces. Erosion of savings dollars, moves into term insurance, replacements, high lapses . . . all are reactions to external influences. If we are to avoid the loss of our share of public savings, we must change. Our traditional products perplex people and lack flexibility. Rates of return are hidden in language and arithmetic that only actuaries understand. We must show competitive results in ways that non-insurance people can measure against other savings forms.

Some charge that Universal Life is a "replacement product." But replacements isn't new; it has been with us and will remain with us, whether or not Universal Life survives. It would be less of an issue if our policies on the books met today's demands. The issue must be, "What is best for the consumer?".

Companies with large blocks of traditional permanent life insurance in force must address the replacement issue in terms not only of other companies but also of their own field force. Should a company openly replace its own business? The answer depends on the specific circumstances. If a company isn't willing to replace its own business, won't it be replaced by somebody else?

Clearly, unresolved issues surround Universal Life. Its present form may or may not be the ultimate solution, but it is a step in the right direction. □

"UNIVERSAL LIFE: THE REGULATORY DILEMMA"

This is the title of a paper written and circulated, specially to regulatory authorities, by Douglas L. Paine, and doubtless obtainable from the author at his Year Book address.

It says that the Universal or Open Life Policy concept may very well represent a turning point for the insurance industry and that the future may see proliferation of such policies.

This paper offers suggestions on nonforfeiture calculations, cost indexes, policy projections (illustrations) and valuation considerations.

Products Do Meet Needs

(Continued)

Today's products do meet people's needs—and will change as those needs change.

Ed. Note: For a distinctly different viewpoint, see "Why Universal Life Is Not The Solution," PROBE, Vol. 28, No. 13, July 1, 1981. Says Probe Editor John L. Lobingier, Jr.:

> "The big question is whether or not the mainstream of life companies will succumb to the current euphoria and bring universal life-type products to market. It would be a mistake for the business to do so, in my view. There are dangers to the universal life approach. There have to be other products and combinations of products that will avoid those dangers and prove to be superior to universal life over the long run—both for companies and for consumers." □

RISK FROM INTEREST RATE SWINGS TO BE DISCUSSED AT ATLANTA

by Carl R. Ohman, Chairman, "C_3 Risk" Task Force

In these hectic times, any actuary who certifies that annual statement reserves make good and sufficient provision for unmatured obligations must take into account the risk of loss from changes in prevailing interest rates. This risk—immediately apparent in Universal Life contracts—was given the symbol C_3 by C. L. Trowbridge's Committee (*Record,* Vol. 5, No. 1, p. 261) in April 1979.

Our Task Force plans to introduce its first report for discussion at the Society's Atlanta meeting on October 20. Our second, final, report will be presented at the Houston meeting in April 1982. The research now underway is expected to prompt extensive subsequent debate and research. □