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## NAIC UPDATE

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A briefing on current NAIC activities.

1. General description of how the NAIC operates
2. Integrated financial services
3. Universal life and variable life regulation
4. Investment aspects of actuarial opinions
5. Cost disclosure
6. New mortality tables
7. Other current topics

MR. RICHARD E. BARNSBACK: The National Association of Insurance Commissioners, better known as the "NAIC," is an organization with which each of us is familiar to some degree. I've been asked to discuss the NAIC in a little more detail so that those of you who aren't directly exposed to that organization will have a better idea of what it is and how it operates.

The NAIC is an organization composed of the chief insurance regulatory officials of each of the fifty states and the U.S. territories. It has been around a long time, having been established in 1871, and has undergone a number of changes over the years. Of current interest are those changes which have taken place over the last three or four years. These recent changes have involved very significant efforts to increase the efficiency of the NAIC and its functioning group, the Support and Services Office. Perhaps the most important changes were: (1) the adoption of a new constitution under which the structure of the NAIC was significantly changed and (2) the moving of the NAIC offices from Milwaukee to Kansas City.

The objective of the NAIC is to serve the public by assisting the several state insurance supervisory officials, individually and collectively, in achieving three fundamental insurance regulatory objectives. Those objectives, as set forth in the constitution, are: (1) maintenance and improvement of state regulation of insurance in a responsive and efficient manner; (2) reliability of the insurance institution as to financial solidity and guaranty against loss (this historically has been and continues to be the primary function of state regulation); and (3) fair, just and equitable treatment of policyholders and claimants.

As described by the Support and Services Office, which as I mentioned is now located in Kansas City, the NAIC performs the following functions to achieve its goals:

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1. Anticipates, identifies, focuses, and attempts to solve insurance related problems in terms of public benefits.
2. Provides service to individual state insurance departments which will assist them in performing their regulatory functions.
3. Improves the exchange of meaningful information between the NAIC and the individual state insurance departments and between the departments themselves in providing substantive information and developing and implementing information exchange systems.
4. Fosters training and continuing education of insurance department personnel to develop and improve technical skills, supervisory and management skills, and policy development.
5. Fosters continued, wider, and more effective participation by members in NAIC activities.
6. Improves the NAIC's and individual state's abilities to favorably impact initiatives at the federal level relevant to insurance regulation. (This is becoming an increasingly important function as more and more bills introduced in Congress directly affect the insurance industry.)
7. Enhances resources available to individual states and to the NAIC.
8. Carries out and improves those administrative activities important to the effective, economic, and publicly acceptable conduct of the NAIC and its operations.

The NAIC is divided into four geographical zones with 12 to 14 contiguous states included in each zone. In order to accomplish its purposes and objectives, the NAIC holds a meeting quarterly, with each zone being the site of one meeting each year. These are recent changes, as the NAIC had been composed for a number of years of six zones, each of which was the site of a zone meeting each year. In addition, two national meetings were held each year. This reduction of annual meetings from eight to four hasn't really proved to be as effective as the NAIC leadership hoped as each of the four meetings has become, in effect, a full-blown national meeting. The NAIC is now in the process of limiting the agendas of the spring and fall meetings so that the primary meetings will be held in June and December.

The officers of the NAIC are the President, Vice President (who also serves as Chairman of the Executive Committee), and the Recording Secretary. Those officers are currently: Bill Gunter, Florida Insurance Commissioner, President; Bruce W. Foudree, Iowa Commissioner of Insurance, Vice President; and Elmer V. "Sonny" Omholt, Montana Insurance Commissioner, Recording Secretary. Those officers together with the immediate past President and the Chairmen, Vice-Chairmen, and Secretaries of the four zones comprise the Executive Committee, which has primary authority and responsibility for NAIC functions. In order to pursue its functions the NAIC is composed of various committees, subcommittees, and

task forces. Under the Executive Committee there are four standing subcommittees: the Internal Administration (EX1) Subcommittee; the Zone Coordination (EX2) Subcommittee; the Market Conduct and Consumer Affairs (EX3) Subcommittee; and the Financial Condition (EX4) Subcommittee. This latter subcommittee, of course, is one of the most important. It has a number of task forces under it and is really the heart of the financial solvency function of the NAIC.

Other standing committees are: the Life Insurance (A) Committee; the Accident and Health Insurance (B) Committee; the Personal Lines-Property and Casualty Insurance (C) Committee; the Commercial Lines-Property and Casualty Insurance (D) Committee; and the Special Insurance Issues (E) Committee.

The Executive Committee, its Subcommittees, and the Standing Committees may establish Task Forces to which specific subjects are assigned. These task forces, a number of which have been appointed, terminate at the end of the December meeting, unless specifically continued for another year. However, a task force dealing with insurance problems that require continuing study may be designated as a Standing Task Force and exempted from the annual continuation requirement. Some examples of the task forces under the Executive Committee are the Constitutional Amendments Task Force, the Integrated Financial Services Task Force, the Life Insurance Taxation Task Force, the Property and Casualty Taxation Task Force, and the Securities and Insurance Regulation Task Force. There's also a special task force on Baldwin-United and there's a Deregulation and Improved Regulation Task Force. As I mentioned, the EX4 is a very important subcommittee. The continuing task forces that are under that subcommittee are the Accounting Practices and Procedures Task Force, the Blanks Task Force, the Data Base Management Task Force, the Examination Oversight Task Force, the IRIS Task Force, the Rehabilitators and Liquidators Task Force, and the Valuation of Securities Task Force.

Task Forces frequently find it helpful to appoint Advisory Committees composed of persons with expertise in the subject being studied. Additional expertise and services are generally provided to the Committees, Subcommittees and Task Forces by the staff of the Support and Services Office (SSO).

The Support and Services Office is composed of management and staff personnel under the direction of the Executive Vice-President who is selected and directed by the Executive Committee. The present Executive Vice-President is E. Benjamin Nelson, former Nebraska Insurance Director. The SSO is engaged in a variety of functions, including: research, analysis, information gathering and dissemination, library services, data collection, data base building and maintenance (this, I might mention, is becoming one of their primary functions), government liaison, non-regulatory liaison, securities valuation (this is a separate office located in New York City), administration, meeting coordination, litigation, legislative and regulatory drafting and educational development. The revenue needs of the SSO are basically derived from assessments on state insurance departments and through the sale of various services, including many useful publications.

By now you may know more than you ever wanted to about the NAIC, but I hope I've given you a good idea of what it is and how it operates. Speaking of the NAIC as an "it" is rather impersonal, as the NAIC is composed of many distinct and interesting individuals. Unfortunately from a continuity standpoint, there is a constant change of state insurance commissioners. This makes the job of getting to know the "players" rather difficult for those working with the NAIC on various matters.

Now that we have considered the NAIC generally, let's look at a specific item that the NAIC is considering.

#### NAIC Activity Relating to Integrated Financial Services

The subject of integrated financial services has concerned the NAIC for some time. Various aspects of the trend toward integration of financial services were studied for several months by different committees, subcommittees and task forces. At its December 1982 meeting the NAIC formally established an Integrated Financial Services Task Force under the Executive Committee. That Task Force has been chaired since it was established by Bruce W. Foudree, Iowa Insurance Commissioner and NAIC Vice President.

On March 30, 1983 the Executive Committee adopted a resolution in opposition to permitting the banking industry to engage in the business of insurance without adequate analysis of the potential impact on the consuming public and on appropriate regulatory mechanisms at both state and federal levels. This resolution was based upon the belief that the best interests of the citizens of the various states are better served by the respective state governments maintaining the prohibition against banks engaging in the business of insurance, and cited the reaffirmation of this principle by federal legislation (the Garn-St. Germain Bill of 1982). Also underlying the resolution was the belief that the unlimited financial activities of the banking industry would create enormous concentration of economic power and coercive potential inimical to consumer interests. Concern was also expressed with the problem of uncertain, unclear and contradictory regulatory standards which could arise.

These concerns have been expressed on behalf of the NAIC, primarily by Commissioner Foudree, on a number of occasions before Congress. In May 1983 he testified before Senator Garn's Committee on Banking, Housing and Urban Affairs and he appeared before Representative Florio's Subcommittee on Commerce, Transportation and Tourism on July 19, 1983. In these appearances he has emphasized (1) the NAIC concerns with the concentration of risks inherent in the integration of financial services and the effect upon solvency regulation; (2) the concentration of economic power and the effects upon consumer protection; and (3) the need to have a cautious and thorough analysis of the impact of combining banking and insurance activities before changes are made in the present system.

Commissioner Foudree again appeared before the Senate Banking Committee on February 29, 1984. He commented on S. 2181, which would have

permitted banks to engage through subsidiaries in the insurance business. He said that the legislation went too far in allowing banks to engage in insurance underwriting. He observed that several sections of the bill could result in federal preemption of state insurance regulation. He noted that the bill's provisions governing transactions with affiliates were much weaker than the standards found in the NAIC Model Insurance Holding Company Act. He concluded that legislators and regulators alike had a responsibility to act very cautiously before dismantling the present regulatory structure.

The NAIC has also commented in writing on proposed revisions to two federal rules. On July 15, 1983 the NAIC commented on the Federal Reserve Board's proposed revision of Regulation Y. On November 10, 1983, the NAIC wrote the Federal Deposit Insurance Corporation, responding to the FDIC's request for comment on whether regulation should be developed to govern direct or indirect involvement of insured banks in expanded non-banking financial activities.

An Advisory Committee was appointed to assist the Task Force in its study of the subject. That Advisory Committee has been ably chaired by Robert S. Seiler, Senior Vice President, Secretary and General Counsel of Allstate Life Insurance Company. He reported to the Task Force on March 6, 1984 that, in order to deal with the many issues presented by this subject, the Advisory Committee had been divided into four subcommittees, as follows:

#### 1. Holding Company Laws and Diversifications

This subcommittee is charged with the study of the NAIC Model Insurance Holding Company Regulatory Act to determine whether changes may be necessary, particularly in the areas of: transactions with affiliates (including dividends); registration requirements; potential application of the anti-trust provisions to acquisitions of insurers by banks; scope of downstream acquisition authority (kinds of businesses and asset limitations); demutualization or alternative forms of mutual company recapitalization; and a comparison of the transaction provisions of the FIDA (Financial Institutions Deregulatory Act) and the NAIC Model. The latter part of the study has been finished with the conclusion that the present NAIC Holding Company Law is probably more comprehensive and better treats the situation than the federal law. This subject, of course, is a very hot item with the Baldwin-United situation and, in addition to it being a part of this particular study under financial services integration, there are other subcommittees looking at the subject of holding companies from other aspects.

#### 2. Unfair Competition

This subcommittee is charged with reviewing the "coercion of debtor" provision of the NAIC Model Unfair Trade Practices Act to determine the need for changes, collecting data on coercion by lending institutions, identifying consumer concerns regarding financial services integration, and identifying areas where

lending institutions may have market or economic advantages over insurers.

### 3. Deregulation

This subcommittee is charged with determining the ways in which existing state regulation of products, prices, agents and insurers may place insurers and agents at a competitive disadvantage in the financial services marketplace.

### 4. Regulatory Conflict

This subcommittee is charged with identifying potential areas of regulatory conflict (state and federal).

The Advisory Committee has been working on a schedule which called for an exposure draft of recommendations to be submitted at the June NAIC meeting. There was a meeting of the Advisory Committee on April 30 and I had anticipated that I would be able to report to you some interesting results of their deliberations. However, a great deal of work remains to be done on these complex issues and it now appears that only a progress report will be given at the June meeting.

MR. SHANE A. CHALKE: My portion of the program today deals with the NAIC Universal Life Insurance Model Regulation and the 1982 amendments to the NAIC Variable Life Insurance Model Regulation. I'll begin my presentation with the Universal Life Model Regulation, as it's by far the more controversial of the two. The Variable Life Regulation seems to have widespread support amongst our profession and there has been virtually no opposition to it.

Although universal life (UL) has been around for quite some time now, there is still a lack of consensus as to what constitutes a "legal" design, that is, a design which complies with the Standard Nonforfeiture and Valuation Laws. Early universal life products used demonstrations of compliance which took a very narrow view of this new life insurance form. With little exception, the underlying assumption in these early versions was that the account value, or side fund, was actually the policy reserve or, in some cases, the policy cash value. Virtually all of the early demonstrations took this approach and I would say 85% of them do now.

There are certain constraints which automatically bind a universal life policy when you take this narrow approach. The first one is that if, in fact, the policy is an unbundling of the reserve structure, the gross premium after removing policy loads (the premium actually deposited into the fund) must equal the valuation net premium. Because net premiums are required to be a constant percentage of gross premiums, this means that any loads taken from the gross premium must be in the form of level percentages in renewal years. For flexible premium plans, this removes the ability to use fixed policy fees, as this would violate the level percentage of premium requirement.

There are many other restrictions in taking this narrow view of universal life (that it is nothing more than the reserve accounting exposed to the policyholder). The most obvious is that first year loads cannot be greater than the valuation (or nonforfeiture) expense allowance. Another requirement is that policy guarantees must be equal to the valuation basis. In other words, the rate of interest guaranteed to the policyholder must be the same as the valuation rate, and the mortality rates guaranteed to the policyholder must come from the valuation mortality table. More subtle is the fact that the fund accounting mechanism (the method of accumulating account values) must be based on the actuarial manner in which reserves accumulate. This last point is the reason that the death benefit is often divided by a factor equaling one month's interest at 4%. It is simply a consequence of trying to make it look like a Fackler reserve accumulation formula and makes very little sense from a pricing point of view.

Policies complying with all of these constraints I'm going to refer to as "classical universal life". As an aside, it's interesting to note that there hasn't been even one policy to my knowledge that actually met all of the tests necessary to rely completely on the classical approach to valuation compliance.

As universal life progressed, companies quickly found it difficult to live within the narrow confines of the classical model. Almost all companies found it desirable to guarantee both mortality and interest rates in advance. To meet profit goals, companies found it necessary to raise guaranteed mortality rates for smokers above those of 1958 CSO. In order to maintain their designs as classical ULs, they treated smokers as substandard, and used the rates guaranteed as the valuation table. Many companies ran into some snags in taking this approach, but this was the basic fallback strategy.

Then came back-end loaded products. It became increasingly confusing to determine exactly where the reserve was. Was it before or after the surrender charge or somewhere in between?

There were still more deviations from the classical model. Companies added fixed policy fees. First year load structures migrated from valuation expense allowances to nonforfeiture expense allowances, and from term allowances to permanent allowances. Policy guarantees, especially on the interest side, got more complicated, and extended for more durations, occasionally even for the life of the policy with some of the indexed plans. Much of this was strategy to avoid dividend treatment for taxation.

By now I may be sounding a little negative by pointing out all of the deviations from the classical universal life. However, the point I'm bringing out is that the classical model is unrealistic. We can't live within the confines of the classical model. To provide the policyholder with a guaranteed rate structure exactly the same as the valuation basis loaded up by a constant percentage is a throwback to the days of mechanical calculators and slide rules.

But we're in luck. Not only is the classical model not well suited to modern product design, it's also unnecessary. Valuation and nonforfeiture compliance can be proven without reliance on all of the constraints originally thought necessary. Obviously there are many forms of life insurance available where the cost structure differs from the valuation basis. And it's possible to put universal life on an equal footing with these other forms of insurance. This is exactly what the Model UL Regulation is designed to do: to relieve universal life of the artificial constraint binding the cost basis to the reserve basis.

Now before I jump into a discussion of just how the Model Regulation works, a little background on the reasoning behind it is in order. The first and most important point is that the account value mechanism was considered to be the cost structure of the policy, and only that. The guarantees of interest, mortality, and loadings take the place of the premium rate in a more traditional form of insurance. It is this premium rate that is unbundled, and not the valuation structure. Now, this may seem like a subtle point, but it was an increasingly necessary and totally different way of viewing the product and it really brought about an entirely different approach toward valuation and nonforfeiture compliance.

The first observation which can be made when adopting this view is that any restrictions on the various characteristics of universal life are unnecessary. There is no justification for the limiting of guaranteed mortality rates, interest rates, or load structures. Any restrictions on these UL items are analogous to stipulating the premium rates on traditional whole life insurance.

The question now arises: where is the cash value? If the various components of the UL policy are not aligned with the reserve or cash value basis, then the account value cannot automatically be considered a good representation of either the minimum cash value or the reserve.

Let's look first at the case of the fixed premium UL policy (known as "irreplaceable life," "interest-sensitive life," etc.). The Standard Nonforfeiture Law (SNFL) defines a minimum cash value in terms of future guaranteed benefits and the slope of gross premiums. With fixed premium policies, all of the information required to calculate a minimum cash value directly from the SNFL is available. We know what the future guaranteed benefits are, although it might take a little bit of calculation to determine them. And we know what the slope of premiums are on a guaranteed basis. With these two pieces of information, the minimum cash value is completely defined.

The Model UL Regulation recognizes this fact. The section specifying cash values for fixed premium plans is basically a restatement of the SNFL, with a bit of explanation as to how future guaranteed benefits are to be found. Quoting from the regulation:

Future guaranteed benefits are determined by (1) projecting the policy value, taking into account future premiums, if any, and using all guarantees of interest, mortality, expense deductions, etc., contained in the policy or declared by the insurer; and

- (2) taking into account any benefits guaranteed in the policy or by declaration which do not depend on the policy value.

The last term, referring to benefits guaranteed which do not depend on the policy value, may seem odd. It's there to point out that policies may have guarantees which exist in addition to what is produced by the account value, and that these "secondary" guarantees are as much a part of future benefits as projected death and endowment benefits. As a matter of fact, there are several policies on the market which utilize such a guarantee. It usually is present in policies where the account value will not support whole life benefits on a guaranteed basis. The policy form will contain an additional guarantee that the policy will turn out to be at least whole life, regardless of the performance of the account value. Obviously, if the guaranteed plan of insurance is whole life, then the minimum cash values must be those of whole life. With these secondary guarantee forms of UL, there may be cases where the minimum cash value is greater than the full account value.

There is one other point of interest with regard to fixed premium UL cash values. When an insurer makes a prospective guarantee after issue, say that interest credits will be at a rate of 11% over the next policy year, the effect is to increase future guaranteed benefits immediately. Since adjusted premiums do not change after issue, there is an increase in the minimum cash value resulting from such a guarantee. The committee developing the Model Regulation felt that this was inappropriate, and the regulation does not require that short term prospective guarantees be taken into account in determining the minimum cash value.

Those of you who have studied the Model Regulation are aware that a markedly different approach is taken in defining minimum cash values for flexible premium plans. During the development period of the methods (which, by the way, spanned over three years), many prospective methods were tried and abandoned. Either the methods were too complex and unworkable, or they produced results which were counterintuitive for extreme cases. It was desired that any method chosen would provide answers identical to those of the classical model for policies which met those conditions. In this way there would be no great disruption of policies already on the market.

Because of the multitude of problems in any application of a prospective method, a retrospective requirement was adopted. It was felt that the most important relationship to the policyholder would be that between the account value and the cash value. This amount, the surrender charge, is the quantity regulated by the Model. Basically, the surrender charge can be no bigger than the unused unamortized portion of the expense allowance prescribed by the SNFL. The Model Regulation specifies that the expense allowance shall be that for level premium, level death benefit endowment insurance at the maturity date. The rationale for choosing a "whole life" expense allowance of this sort was thought out carefully. It was felt that most of these plans were sold as a substitute for traditional forms of permanent insurance. In addition, the expenses incurred in putting one of these policies on the books is comparable to plans where the whole life expense allowance is permitted. Any expense allowance smaller than that for whole life would leave universal life plans at an unfair disadvantage in comparison to traditional plans of insurance.

It is important to note that neither the requirements for fixed or flexible premium plans contains any limitation on the level of guaranteed mortality charges. Many insurers have run into problems when charging more than 1958 CSO rates for smokers. As I mentioned previously, insurers were required to consider smokers as substandard in order to justify the higher rate. It is ironic to note, however, that mortality rates higher than 1958 CSO provide a conservative cash value, that is, a cash value higher than that required by law. Although this may seem illogical at first glance, we should all strive to make this clear in our cash value demonstrations.

The logic goes like this: minimum cash values are based on guaranteed benefits. To find guaranteed benefits, the account value is projected forward using the policy guarantees of interest and mortality. The minimum cash value is the present value of these benefits where the present value is calculated on the nonforfeiture basis. In the case where the guaranteed rates are equal to the 1958 CSO rates, the projection and present values will cancel each other out, leaving you with the account value. The minimum cash value is equal to the account value adjusted for the remaining expense allowance.

Now consider the case where the guaranteed mortality rates are greater than those of the 1958 CSO. Projecting the account value forward to find the future benefits obviously yields lower future benefits than if the projection were made using the 1958 CSO. Yet these lower benefits are still valued using the nonforfeiture table (1958 CSO), resulting in an amount less than the account value, which is then adjusted for the expense allowance.

What does all of this prove? Simply that guaranteed rates greater than the 1958 CSO rates will provide a cash value which is larger than that required by law, and not lower. Regulators should be far more concerned with guaranteed mortality rates less than 1958 CSO rates than with rates which are higher. It is unfortunate that we have let this thing go as far as we have. Furthering the supposition that guaranteed rates must be less than or equal to the nonforfeiture rates may be somewhat workable now, but will become unbearable as we move toward the 1980 CSO. 1980 CSO mortality rates are lower than what is prudent for many companies to charge in the context of a UL plan.

I'd like to make one further point regarding cash values for flexible premium plans. In general, using the retrospective approach outlined in the Model Regulation, minimum cash values are higher than those for comparable traditional plans. To explain this it's necessary to analyze the surrender charge implicit in a traditional whole life plan. In relation to the reserve, two forms of surrender charge are allowed in bringing the amount down to the level of the cash value. First is the unamortized expense allowance. No surprises here. This is the basic surrender charge that is allowed in traditional plans. In addition, however, the cash value is often calculated using a rate of interest higher than that used in calculating the reserve. This second form of surrender charge, the "interest differential," is the amount lost when using a retrospective approach to UL nonforfeiture values. This sacrifice was made in the interest of simplicity and workability.

I'm now going to move on to the subject of reserves. This is probably the most unusual part of the regulation and the part that invariably gets the most questions. The UL reserve methodology is merely an interpretation of the Standard Valuation Law, not a reworking of it. The method for calculating minimum reserves is the same for both fixed and flexible plans of insurance, and is prospective in nature. As I implied previously, in order to use a prospective method an assumption as to future premiums must be made. The Model Regulation assumes that future premiums will be paid at the whole life level, and calls this premium the GMP (the guaranteed maturity premium). The GMP is analogous to the guideline level premium (GLP) from TEFRA, the only differences being in the area of assumptions. The GMP is calculated using plan guarantees, regardless of their level, and with no restrictions on plan form (20 year endowment, 10 pay life, etc.). For most plans, however, the GMP should be equal to the GLP from TEFRA.

One more concept is necessary before we define the reserve. If the GMP is paid each year from issue, and interest credits and mortality charges are at the guaranteed rates, then the plan will exactly endow for the initial face amount. The observed account value in each year is termed the GMF (guaranteed maturity fund). We'll see how this is used in a moment.

Now the reserve at any point in time is going to be equal to the present value of future benefits less the present value of future valuation premiums...sounds familiar. Just what are the future benefits? Well, it's impossible to tell just by looking but we do have all the assumptions necessary to find out. We can project the account value into the future, assuming that the GMP is paid each year, and using the policy guarantees. This will give us the death benefit each year and the final endowment value. The reserve is the present value of these benefits less the present value of valuation premiums. The future benefits are valued on the valuation basis, which may or may not be the same as the basis for the policy guarantees. The valuation basis allowed for UL is the same as for traditional plans of insurance. The valuation premium used in this calculation is not the gross premium minus the loading. Rather, it is the same as for a traditional plan and does not change after issue. This all sounds very complicated, this projection and discounting procedure, but don't worry, it gets worse.

In addition to everything I just went through, there is this troublesome little "r" factor. The regulation says that, if the actual account value is less than the GMF, use the GMF instead and then multiply the result by "r", the ratio of the account value to the GMF. So if your actual account value is half of your GMF, you calculate the reserve pretending that it is the GMF, and then take half of it when you're all done. I'm really surprised that the "r" factor didn't get more publicity, because it really seems as if it came right out of left field.

The purpose of the "r" factor, however, is really quite simple. If the actual account value is less than the GMF, then future guaranteed policy benefits will run out before the maturity date. This is true because the GMF is that amount which is exactly on target to mature the policy. Therefore, anything less than the GMF will be insufficient to mature the

policy on a guaranteed basis. It was felt that, in order to reserve adequately for all policy guarantees, it would be desirable to make sure that any projection of benefits extends until the maturity date of the policy. For example, if a policy had especially favorable mortality rates at the older ages, using a minimum of the GMF for projection purposes will ensure that these late duration mortality rates are taken into account. Once the reserve is calculated using the GMF, then the result is reduced proportionately to the account value.

Another purpose of the "r" factor was to ratio the CRVM expense allowance. If you have a very low fund, you get something less than a whole life CRVM expense allowance. But this was a secondary purpose that was taken into consideration later in the development of the method.

Now I admit that all of this sounds extremely complicated, and you may not have followed the description I laid out. But what I'm about to say is probably the most important part of my talk today. Although read literally the Model Regulation has sections that seem exceedingly complex, for those plans which are designed under the classical model the reserve can be reduced to a simple formula involving only a one-step adjustment to the account value. No projection and discounting is necessary. For those plans which deviate from the classical model only by way of one-year prospective guarantees, a simple two-step adjustment will suffice.

The valuation method was designed such that those who wanted to try more esoteric forms would not be prohibited from doing so, yet for 90% of the plans out there the calculation would be very simple. For fixed premium plans, the method is simpler still. The GMP is always equal to the gross premium, and the account value can never be less than the GMF. Therefore, the "r" factor never comes into play. In addition, if the plan is designed under the classical model, then the reserve is, again, a simple adjustment to the account value.

The major point that I'm making is that there is no reason to consider the method too complex...for almost all plans you can continue to do things without additional complexity.

Looking into the future, however, the door is left open for more and more experimentation in plan design. Without the cost basis tied to the valuation or nonforfeiture basis, I can envision plans where the guaranteed interest rate differs from the valuation rate, or where guaranteed mortality rates more accurately reflect the risks involved. With this in mind, we have to keep our eyes open for the sort of back door rate regulation which I mentioned previously, that is, the regulation of guaranteed mortality and interest rates. Any moves in this direction would circumvent the intentions of the Model Regulation.

Another aspect of the Model Universal Life Regulation involves a special requirement for indexed plans. The regulation requires that a "Statement of Actuarial Opinion" be filed annually with the insurance department. The Statement says that the actuary has examined the characteristics of both the indexed policies and of the underlying assets, paying attention to such items as the relationship between credited interest rates and

cash flows, the effects of reinsurance agreements, and other effects of changes in interest rates. The Statement concludes by saying that the anticipated insurance and investment cash flows make good and sufficient provision for the contractual obligations of the insurer under the policies.

This statement seems reasonable enough, and certainly contains things that should be considered even in the absence of such a requirement. By many on the committee, however, this was considered to be the most controversial portion of the Model Regulation. Why?

This is the first time that actuaries have been asked to consider the asset side of the balance sheet. Many will say that it's about time. Some will say that we're beyond the scope of an actuary's professional capabilities. I suppose that I'm in that group that feels that it's about time. What I find unusual about this is that it appears for the first time in relation to indexed plans. Many of the indexed plans, when backed with an appropriate investment strategy, are safer than traditional forms of permanent insurance from an investment point of view. This was an opinion shared by many on the committee developing the Statement of Actuarial Opinion. The upshot of this, I believe, is clear. This is the beginning of this sort of certification, and not the end. As we learn more about the risks inherent in various forms of insurance, I think we'll find that any justification which exists for requiring an actuarial opinion for indexed plans is also present in many other forms of insurance as well.

I'm going to jump over to the Variable Life Insurance Model Regulation now. During the early days of variable life (VL), three forms of the product were talked about to some extent. They were all based on the participating whole life form of insurance. All three of the forms relied on the concept of an assumed investment rate. This was the rate of interest which, if earned in the separate account, would result in the policy remaining as a level face amount whole life policy. The three forms of variable life differed in the way in which investment experience different from the assumed investment experience was treated.

The paid-up additions (or Equitable) method used any additional investment income to purchase paid-up additions. Any shortfall in investment income caused the purchase of negative paid-up additions until the shortfall was made up.

The New York Life method used additional investment income to purchase premium-paying additions. If there was a shortfall in investment income, negative premium-paying additions were purchased as under the Equitable method.

The third form, the Dutch design, was completely unit-based insurance, with the premiums, face amount, and cash value all varying proportionately with the performance of the separate account.

Only the first two methods, the paid-up additions and the New York Life method, were permitted by the original Variable Life Regulation. It was felt at that time that the Dutch design, with its varying premiums, would

add unwarranted complexity to an already complex form of life insurance. Thus, the original VL Regulation required that any VL policy have fixed premiums.

Now the reason that I went into a little bit of VL history is that I wanted to set the stage for the two most significant changes between the previous VL Regulation and the new one. First, the new VL Regulation allows for policies with flexible premiums. Second, the new regulation no longer requires that policies be based on traditional dividend mechanisms such as paid-up additions. Like UL, any "excess" investment experience can be credited directly to the cash value with no direct effect on the current face amount.

In addition to these two, I'll go through a brief overview of the more significant changes from the previous VL Regulation. The old regulation limited the form of insurance to whole life; now any form of insurance is valid. Previously, a guaranteed minimum death benefit was required equal to the initial face amount. This requirement was retained for fixed premium policies, but dropped for those with flexible premiums. Both of these requirements were added to the original Model Regulation in an attempt to curtail SEC involvement in VL. Many of the requirements developed with this in mind were dropped in framing the 1982 amendments. Another requirement falling in this category involved maximum premium rates. This requirement has been dropped completely.

The ten-day free look provision has been changed to allow the insurer to return any loads assessed plus the current value of the policy's share of the account, rather than the full amount of premiums paid. This will remove the ability of policyholders to use the ten-day free look for speculative purposes. To make use of this provision, legislative changes will be required in some states.

The 1982 amendments add the requirement of a sixty-one day grace period for flexible premium plans, analogous to typical requirements for general account UL. The death benefit during the grace period must be equal to the death benefit immediately prior to the grace period less any overdue charges.

Upon increases in death benefit within the same policy, the incontestability period and the suicide clause may begin again for the amount of the increase.

With the 1982 amendments, at least 75% of the cash surrender value must be available for loans, compared with a maximum of 75% in the original regulation.

The amendments allow partial surrenders to be made without a reduction in the policy's death benefit. Previously, partial surrenders were allowed only when treated as a partial surrender of the entire policy.

The amendments prescribe a method for calculating the reserve for any guaranteed death benefit provision for flexible premium policies. Basically, the method requires an assumption of an immediate one-third depreciation in the value of the assets in the account, followed by

investment earnings at the valuation rate. The reserve is the present value of any benefits occurring as a result of the death benefit guarantee.

The laundry list of permitted and disallowed investments has been deleted, since it was too restrictive and redundant in light of the fact that these plans are also regulated under the 1940 Investment Act.

Charges which can be levied from the separate account had been limited to a specific list. This limitation has been removed as well as any maximums on specific charges.

The 1982 amendments add a policyholder statement requirement. An annual statement must be supplied to the policyholder which shows a reconciliation of cash value, withdrawals, premiums, charges, etc. This requirement is analogous to that for universal life contracts.

In addition to the above, there are several open questions with regard to variable universal life (VUL). The Model Regulation is not specific as to valuation and nonforfeiture requirements. The possibility exists that the methods outlined in the UL Regulation could be applied to VUL, perhaps using an interest assumption equal to the valuation rate. This would make a great deal of sense, both from the standpoint of uniformity and with the goal in mind of preserving additional flexibility for VUL.

After this short course on the UL and VL Regulations I'll now briefly tell you where they stand with the various states.

Within the next couple of months, the Universal Life Model Regulation should be in place in five states: Wyoming, Arkansas, Ohio, Nebraska, and Illinois. Wyoming, by the way, intends to adopt it minus the nonforfeiture and valuation provisions. By the end of the year, we expect to have eight more states: Georgia, Pennsylvania, Texas, Michigan, North Dakota, Virginia, Florida, and South Carolina. How can we know all this? Well, the industry advisory committee sent out a detailed survey to the various state insurance departments asking their opinion on the regulation, when they intended to adopt it, what changes they might want to make, etc. This information is based on the responses received to the survey.

With respect to the amendments to the Variable Life Model Regulation, I should mention that the ACLI is not seeking adoption in all the states, only in those states where there is a prior conflict in either regulation or legislation. The goal is to allow variable universal life to be sold in all states. To do that, it's going to be necessary to have the regulation adopted in something between 30 and 35 states. The progress on this is a little further along. It has already been adopted in seven states: Arkansas, Iowa, Maine, Delaware, Kansas, Minnesota, and Mississippi. In North Dakota adoption is very close.

Over the next couple of months, we expect to have four to six more states: Alaska, Colorado, Indiana, and Nebraska. A little less close but still on line are Virginia and Texas. We expect to continue to see rapid progress with the variable life amendments because they are quite

noncontroversial. No one has brought up any substantive objections to any of the wording or the provisions. It is generally felt that they are good and necessary changes.

MR. ANTHONY T. SPANO: Thank you, Shane. I have one additional detail that I might mention with respect to the Universal Life Model Regulation. As Shane mentioned, the Wyoming department is seriously considering adopting the Model Regulation without the valuation and nonforfeiture provisions. The reason is that they feel that these provisions are redundant. If you have a valuation law and a nonforfeiture law, why do you need these additional guidelines? Well, the fact is that the valuation and nonforfeiture laws as amended in 1980 state that there are certain plans which simply will not fit these laws. In those situations the commissioner is authorized to promulgate regulations. We have been trying to convince the Wyoming department about this and feel there is still a chance they may get turned around.

I'm now going to talk about cost disclosure, which is one of the subjects that I have been following closely at the ACLI. Before I go into my presentation, I would just like to mention one point that I think is important. The NAIC adopts model regulations like the Variable Life Model Regulation and the Universal Life Model Regulation, and it adopts model laws like the Valuation and Nonforfeiture Model Laws and the Policy Loan Interest Rate Model Law, but the NAIC cannot enact those regulations or laws in the states. Each individual state must take action. Shane referred to how much action, or in some cases lack of action, there has been with respect to the Universal Life and the Variable Life Model Regulations.

The NAIC model regulation on cost disclosure is officially referred to as the NAIC Life Insurance Solicitation Model Regulation and it is this regulation that I will be talking about.

Background. The original Life Insurance Solicitation Model Regulation was adopted by the NAIC in 1973, and an expanded version was adopted in 1976. Today, 4 states have regulations based on the 1973 version, and 34 states have regulations or laws based on the 1976 version.

The 1976 model regulation requires life insurance companies to give all prospective purchasers of life insurance a specific "Policy Summary" and "Buyer's Guide" as basic disclosure tools. The Policy Summary is an exhibit which must include figures on premiums and benefits for the policy under consideration. Figures must be shown for certain prescribed policy years so as to provide a representative selection from all the financial facts that might be reported about a policy. Also included in the Policy Summary are ten- and twenty-year net payment cost indexes, surrender cost indexes, and equivalent level annual dividends, calculated on the interest-adjusted method assuming five percent interest. These numbers enable the consumer to compare the cost of similar policies.

The Buyer's Guide is a booklet to help people shop for life insurance. It describes how much life insurance to buy, what kind to buy, and how to compare the price of similar policies. There are brief descriptions of the basic types of policies and instructions on how to use the cost indexes.

The 1976 regulation had hardly been adopted by the NAIC when it was suggested that some additional enhancements and changes might be appropriate. In 1979, the NAIC appointed a task force to study a possible revision, and the new products explosion that started about then led to an emphasis on making the regulation responsive to the changing marketplace. Work on a new regulation progressed slowly, in large part because of several changes in the chairmanship of the task force and because of an uncertainty on how best to handle the new products that were coming on the scene. A draft of a revised regulation was exposed by the NAIC in 1982 and, finally, a new model regulation was adopted at the December 1983 NAIC meeting.

The new regulation was the result of a broad effort involving the NAIC, the ACLI, and the American Academy of Actuaries. The major purpose of the revision was to update the regulation and the accompanying Buyer's Guide to accommodate today's marketplace. In addition, the new regulation provides for additional disclosure designed to help both the consumer and the regulator. However, while the revision involved some extensive changes, the fundamental structure of the disclosure system provided by the previous regulation was retained. Let's now turn to the principal changes that were made.

New Features. The following are the significant new features of the revised model regulation:

1. A requirement for furnishing interest-adjusted indexes on both guaranteed and illustrated bases. This replaces the requirement in the previous regulation for showing the interest-adjusted indexes on an illustrated basis accompanied by the equivalent level annual dividend. The change reflects the great variety of nonguaranteed factors that are now incorporated in life insurance products.
2. A Special Plans section to accommodate the unique features of policies such as enhanced ordinary life (under which dividends are applied to maintain a level death benefit), universal life, multitrack policies, and revertible term.
3. A provision for disclosure of dividend practices to both new and existing policyholders. The company must disclose whether it is on a portfolio basis or an investment year basis and must also tell the policyholder if dividends are not based on accepted actuarial principles. The Academy has defined accepted actuarial principles for mutual companies and is now in the process of doing so for stock companies.
4. A provision for disclosure to regulators and policyholders of unusual patterns of premiums and benefits. The regulation includes a mechanism to test for premiums and benefits which follow an unusual pattern. This is in response to some charges that have been made that companies manipulate cash values and dividends so as to come up with deceptively good-looking cost indexes at ten years and twenty years.

5. A provision enabling policyholders to request additional information relating to future premiums, benefits, and other items affecting policy costs.
6. Changes in disclosure requirements to accommodate (i) adjustable policy loan interest rates and (ii) procedures under which policy dividends or excess interest credits reflect the extent of loan activity on a policy-by-policy basis ("direct recognition").
7. A new Buyer's Guide, with changes designed to take account of recent product developments and to enhance the Guide's readability and usefulness.

The Future. Now let me say a few words about where we go next.

For this year, I would not expect much action by the states on the revised model regulation. The ACLI supports the new regulation and has written to the state insurance commissioners urging that they adopt it. However, it takes time to digest any new regulation, particularly one as extensive as this. Also, 1984 has been a very busy year for both the regulators and the industry. Baldwin-United, guaranty fund laws, unisex legislation, federal income taxes, bank deregulation--these and other issues have overshadowed cost disclosure on the priority list.

But there are forces at work, some just starting to stir, that may cause some real movement on the new regulation in 1985. The increasing popularity and variety of new life insurance products are serving to make the old model regulation, particularly the old Buyer's Guide, appear more and more obsolete. In Washington, the Federal Trade Commission (FTC) and now also the House Judiciary Committee are studying the adequacy and quality of consumer information on life insurance. The FTC is committed to presenting a report on the subject by January 1, 1985, and Congressional interest in the subject may very well continue for an extensive period. It is very possible that these forces, especially if accompanied by an easing of some of the other regulatory and industry concerns, will soon spark action on the new regulation in the state capitals.

MR. GARY E. DAHLMAN: The 1980 amendments to the Standard Valuation and Nonforfeiture Laws allow the insurance commissioner in each state to permit life insurers to use new mortality tables after such tables have first been approved by the NAIC. In a few states the wording of the model law was modified to allow the commissioner to act on his own without prior NAIC approval. The purpose of this change in the Standard Valuation and Nonforfeiture Laws is to avoid the necessity of the time-consuming process of seeking legislative approval in each state and thereby allow new mortality tables to be brought on stream much more quickly than has been the case in the past.

The demand for a new mortality table sometimes comes from the life insurance industry (for example, to reduce or eliminate deficiency reserves), or from a concern on the part of regulators. In either case, the Society of Actuaries is usually asked to develop the new table by the NAIC Life and A&H Task Force, which is the group of state insurance

department actuaries who advise the NAIC on actuarial matters. In most cases mortality tables developed by Society committees are exposed to the membership for comment before being formally recommended to the NAIC actuarial group. The Society's recommendations are usually referred to the Standing Technical Advisory Committee (STAC), an industry advisory group of actuaries formed when the 1980 amendments were under consideration, for review and comment. On occasion the Academy's Life Insurance Committee or the ACLI's Actuarial Committee may be asked to review the proposed tables and submit comments, or may volunteer such comments. The meetings of the NAIC Life and A&H Task Force are open to the public and companies or individual actuaries may also submit their own comments or suggestions.

Once approved by the NAIC actuarial group a proposed new mortality table must work its way through the various levels of the NAIC described earlier before reaching the commissioners and receiving final approval. Usually, but not always, the proposed new mortality table is relatively noncontroversial and approval by the commissioners is pretty much assured once the recommendation of the NAIC actuarial group has been secured.

In order to facilitate the adoption by the individual states of new mortality tables approved by the NAIC, the NAIC Life and A&H Task Force has prepared model regulations for the individual commissioners to use in adopting the new tables.

To date the following new mortality tables have been approved by the NAIC since the enactment of the 1980 amendments:

- (1) the 1983 Table "a" for individual annuities
- (2) the 1983 GAM Table for group annuities
- (3) the 1980 CSO blended mortality tables
- (4) the 1958 CSO and 1980 CSO Smoker and Nonsmoker Mortality Tables

In the rest of my presentation, I'm going to talk separately about each of those tables to give you a little background and let you know where they currently stand.

#### 1983 Table "a" and 1983 GAM Table

The 1983 Table "a" was developed by the Society's Committee to Recommend a New Mortality Basis for Individual Annuity Valuation. It was approved by the NAIC in 1982.

The 1983 Group Annuity Mortality Table was developed by the Society's Committee on Annuities and was approved just last December by the NAIC, at which time the model regulation originally put together for the 1983 Table "a" was amended so that the states could adopt both these annuity tables together.

Under the model regulation for adopting the 1983 Table "a," it may be used for the valuation of individual annuity contracts issued on or after the effective date of the 1976 amendments to the Standard Valuation Law and prior to the effective date of the adopting regulation. It must be used on or after the effective date of the adopting regulation. In addition, the 1983 Table "a" may be used for the valuation of annuities purchased under group annuity contracts on or after the effective date of the 1976 amendments and prior to the effective date of the adopting regulation.

The 1983 GAM Table must be used for the valuation of annuities purchased under group annuity contracts on or after the effective date of the adopting regulation. In addition it may be used for annuities purchased under group annuity contracts on or after the effective date of the 1976 amendments and prior to the effective date of the adopting regulation.

One thing to keep in mind is that both the effective date of the 1976 amendments and the effective date of the model regulation enacting the new tables will vary from state to state. The periods of time covered will not be the same.

#### 1980 CSO Blended Mortality Tables

As of August 1, 1983 it became necessary for business falling under the scope of the Norris decision to offer the same premiums and policy values to both men and women. This did not pose a problem for companies still on the 1958 CSO Tables, but did create a significant problem for companies that had already converted to the use of the sex-distinct 1980 CSO Tables. In response to pressure from the industry, and also from certain women's rights groups, the Executive Committee of the NAIC at its September 1983 meeting adopted an interim procedure allowing "blending" of the 1980 CSO Male and Female Tables. This action was communicated by the President of the NAIC to all state insurance departments on October 21, 1983.

Under this interim procedure use of blended 1980 CSO Mortality Tables was not restricted to cases covered by the Norris decision. Rather, insurers were permitted to use the regular 1980 CSO Tables, or blended versions thereof, at their discretion. Furthermore, the blending percentage could be selected by the insurer and could vary from plan to plan. Minimum valuation standards would still be based on the sex-distinct 1980 CSO Tables even though unisex tables might be used for policy values. That was because reserves are a matter between insurance departments and companies and are not affected by the Norris decision. As an aside, that could create deficiency reserve problems on some policies where the gross premium rates are unisex but the male valuation premiums are still based on the 1980 CSO Male Table.

At its October 1983 meeting the NAIC actuarial group discussed the interim procedure adopted the previous month by the NAIC Executive Committee. The actuarial group concluded that it would be advisable to specify certain blending percentages to be used by life insurers rather than leaving the choice of the blending percentages to each individual company. It was decided to recommend that five blended mortality tables

be permitted (based on male percentages at pivotal age 45 of 100%, 75%, 50%, 25%, and 0%), with the 100% male and 100% female tables to be permitted only until December 31, 1984 (due to pressure from the women's rights groups). The three new tables could be used until December 31, 1988 as it was anticipated that a permanent solution to the problem would be available by that date.

The Society's Committee to Recommend a New Mortality Basis for Individual Annuity Valuation was asked by the NAIC actuarial group to construct the three new blended tables. After first changing its name to the Committee on Nonforfeiture and Valuation Mortality Problems - Individual Life Insurance and Annuities it promptly went about its task. During the course of its work the Committee concluded that additional blended tables would be preferable in order to give insurers a wider range of choice, so in addition to the five-table approach described earlier, a seven-table alternative was also constructed based on the following male percentages: 100%, 80%, 60%, 50%, 40%, 20% and 0%.

At its December 1983 meeting the NAIC actuarial group opted for the seven-table approach. The interim procedure was also amended to permit the continued use of the all-male and all-female tables after December 31, 1984 provided 90% or more of the insureds are either male or female, or for use with group conversions. The NAIC accepted the recommendations of its actuarial group and the interim procedure, as amended, was adopted as a model regulation.

At this point separate smoker and nonsmoker versions of the blended tables have not been constructed or approved.

#### 1958 CSO and 1980 CSO Smoker and Nonsmoker Mortality Tables

Prior to the release of the State Mutual Life nonsmoker mortality study only a handful of companies were offering premium discounts to nonsmokers. Now most companies have separate smoker and nonsmoker premium rates, at least on some of their products. The use of composite valuation tables (smokers and nonsmokers combined) for reserve purposes causes gross premium deficiencies on most nonsmoker business issued on a guaranteed premium basis. This triggers minimum reserve calculations on permanent plans, and for the current term period on renewable term plans, as well as a requirement for "additional reserves" on renewable term plans under Actuarial Guideline IV of the NAIC Examiners Handbook. In some cases substantial reserves in excess of basic reserves may be required. Some of this problem has been alleviated through the use of indeterminate premium plans or, in the case of term insurance, the modified premium whole life version where the gross premiums in the later years are set high enough to avoid deficiency reserve problems.

Pressure from the industry prompted the NAIC actuarial group to look for a solution and a request was made to the Society to develop smoker and nonsmoker mortality tables for valuation purposes. Since it will still be several years before the Society's ongoing mortality studies will produce meaningful results for smokers and nonsmokers separately, a special task force was appointed to investigate the possibility of an interim solution for valuation purposes.

The Society's Task Force on Smoker/Nonsmoker Mortality developed a split of the 1980 CSO Table into smoker and nonsmoker components and released a report to the Society membership for comments early in 1983. No substantial objections were voiced and the final report of the Committee was submitted to the NAIC actuarial group last fall. At the request of the NAIC actuarial group the Committee's recommendations were also reviewed by the STAC.

The STAC recommended adoption of the proposed 1980 CSO Smoker and Nonsmoker Mortality Tables with an extension of the scope to include policy value calculations as well as valuation (at the option of individual companies). In fact, under the model regulation adopting these tables, companies have three choices on plans that offer smoker and nonsmoker premiums. One choice is they can just continue to use the regular 1980 CSO composite table. The second choice is they can go completely into the new smoker/nonsmoker tables for both reserves and policy values. And the third choice, which I expect to be perhaps the most common, is to use the regular 1980 CSO Tables for basic reserves and for policy values, but to use the smoker/nonsmoker tables under the minimum reserve provisions of the Standard Valuation Law. That is, the gross premium may be deficient when compared with the net premium based on the regular 1980 CSO Tables, but not deficient when compared with the net premium based on the nonsmoker tables. So, under the minimum reserve provision of the Standard Valuation Law, the need for a "deficiency reserve" can be avoided.

These tables were approved by the NAIC actuarial group and the commissioners at the NAIC's December 1983 meeting.

In the meantime John Gilchrist of the California Insurance Department developed smoker and nonsmoker versions of the 1958 CSO Tables using the same approach that was employed by the Society Committee in splitting the 1980 CSO Table (except with the assumed smoker percentages adjusted to reflect the appropriate time period). The model regulation drafted by the STAC for implementation of the 1980 CSO Smoker and Nonsmoker Mortality Tables was amended by the NAIC actuarial group to permit also the use of the 1958 CSO Smoker and Nonsmoker Mortality Tables. The availability of the smoker and nonsmoker tables for 1958 CSO business is not retroactive. In order to use these tables it is necessary to make the 1980 amendments operative for a given plan and then use the 1958 CSO Smoker and Nonsmoker Tables as a substitute for the 1980 CSO Tables.

It is my understanding that the NAIC actuarial group plans to amend Actuarial Guideline IV of the NAIC Examiners Handbook in order to permit the use of smoker and nonsmoker valuation tables in the calculation of "additional reserves" on renewable term insurance plans.

Now, let's review the current status. I think partly due to all of the activities on the agenda to which Tony just referred not much has happened. Very few states have acted. The information I have may not be quite up-to-date, but let me give it to you anyway.

New York adopted the 1983 Table "a" for individual annuities last year for annuities issued after January 1, 1984. No other states have adopted

the table yet. Proposals have been published and hearings held in at least three states so far concerning the two annuity tables, and those states are Maine, Michigan, and South Carolina.

On the blended 1980 CSO tables, two states, Montana and South Carolina, adopted the interim procedure that the NAIC Executive Committee passed at its quarterly meeting last September. That interim procedure allows the company to select its blending percentage as opposed to the specified tables. My understanding of the ACLI position on this question is that the ACLI won't oppose the use of the original interim procedure because it's more liberal from the point of view of the companies. There is visible activity in at least six other states: Iowa, Kansas, Maine, New Jersey, Michigan, and New York. There are a couple of significant departures from the model regulation in Michigan and New York that I want to mention. Remember now, these are just proposed. These have not been enacted yet. In Michigan, the new tables will apply to business believed to be covered by the Norris decision. The model regulation doesn't specify; it leaves the company free to choose. Finally, in Michigan, there are no exceptions to the one-year limitation on the all-male/all-female tables. You can use them for one year and that's it. The model regulation includes a couple of exceptions to allow those tables to continue after one year.

In New York, although the seven tables will be listed, the proposed regulation allows any other table to be used. So, in other words, it falls back to the original procedure of allowing the company to choose its blending approach. In New York, the proposal also applies to reserves as well as the policy values so that potential deficiency reserve problems wouldn't apply in New York if the proposal passes.

On the smoker/nonsmoker tables, again not much activity. I understand that New Jersey will permit the use of the tables without any adopting regulation. No other state has actually adopted them yet. There is visible activity in three states: Maine, Michigan, and New York. And here again, there are some departures from the model regulation. In Michigan, the use of smoker/nonsmoker tables on plans that have smoker/nonsmoker premiums would be mandatory beginning January 1, 1986 rather than optional. In New York, the proposal also allows for blending by sex, which is not in the model regulation.

Now, in closing, I had a couple of other comments that are indirectly related to mortality tables. I understand that Alaska has now passed the 1980 amendments. All 50 states have now passed the amendments, although the District of Columbia still has not. And, finally, Wyoming's version of the 1980 amendments had a final date for changing over from 1958 CSO to 1980 CSO of January 1, 1985. Thanks to intense lobbying from the ACLI, and maybe due to the change in leadership up there, that date has been pushed back, not all the way to January 1, 1989 as in the rest of the states, but to January 1, 1987. So, that does give companies a little bit more breathing room in Wyoming. Thank you.

MR. PAUL D. YEARY: I'd like to ask Shane a question. In a situation where "r" equals one, it seems that the fund that you've accumulated has already allowed you to deduct first year expenses because you deduct the

expenses as they occur in the guaranteed maturity fund. Also, then you deduct the CRVM expense allowance amortized over future years in coming up with the minimum reserve. Aren't we really allowing deduction of first-year expense allowances twice in the minimum standard?

MR. CHALKE: No. What happens is that when you use the guaranteed maturity fund to project forward you're going to end up with benefits that are equal to whole life. Then, when you take the present value of those benefits, you end up with a whole life single premium and you subtract the expense allowance. If you have an additional expense charge in year one, it's made up in sufficiencies in renewal guaranteed maturity premiums. Any expense charge taken up front is fed back into the mechanism when you project.

MR. YEARY: It seems to me that, if you plugged in the same thing on a traditional method, what you would plug in would be the net level premium reserve at that time, which would be higher and go forward.

MR. CHALKE: No, it would not be the same because the guaranteed maturity premium is not the same as a net premium. And in the case where you take a first-year load, your guaranteed maturity premium is going to be greater than a net valuation premium. When you take those into account in projecting, you come out with more benefits than you would under the classical case.

MR. STEVEN R. LINNEY: It is very difficult to keep track of all these various state enactments and I was wondering, Tony, how you see the ACLI being able to help. Will you be sending out a list or something regularly showing where we are with all these various new mortality tables and whatever?

MR. SPANO: Yes, Steve. We have done that with each of the amendments to the valuation and nonforfeiture laws. We had a series of bulletins that we sent out with respect to the '80 amendments, as we did years ago with the '76 amendments, and before that, the '72 amendments. I would anticipate that we will do the same thing as soon as we get enough states for it to be worthwhile. We certainly are monitoring the situation and will keep our member companies informed.

MR. DAHLMAN: Shane, you mentioned that currently 85% or so of the actuarial demonstrations for UL are still being submitted on the classical or traditional basis. How have the insurance departments reacted to the other 15%? Are policy forms, demonstrations, and approvals getting through on that basis?

MR. CHALKE: I'd say it's a significantly greater amount of work to do the convincing process, but it has been done by many companies. It has been successful but definitely requires a more carefully thought out strategy.