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Debaters: LARRY M. GORSKI
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Recorder: R. THOMAS HERGET

Summary: The National Association of Insurance Commissioners (NAIC) has adopted a new regulation redefining the application of the Commissioners Reserve Valuation Method (CRVM) to traditional life and universal life policies. This session focuses on implementation and interpretation issues:

- *status of regulation among states*
- *special features of XXX for the unwary observer*
- *comparison of XXX to New York 147*
- *tax ramifications*
- *implementation issues*

Mr. R. Thomas Herget: I promise you it's going to be a very interesting session. We met to discuss what we wanted to talk about, and I had to keep these two gentlemen apart at different tables.

First, introductions. I am with the firm PolySystems and am the moderator of the debate. We've asked these two industry experts to prepare responses to seven questions. They will each have an opportunity to give their viewpoints on the questions and then respond to what the other has said.

After these seven questions have been addressed, we will entertain questions from the audience. We'll do that in a slightly different fashion. If you have a question, please write it down on a piece of paper and raise your hand. One of the

chairpersons for the workshop that is following this session, Rebecca Evans, will come over and pick it up. She will edit it so that it's an appropriate question for a debate.

We're still having a debate over who's the protagonist and who's the antagonist, but here are the questions:

1. What is the best reserve methodology for term insurance?
2. How can this regulation, which forgives deficiency reserves if guarantees are less than five years, prevail over the Standard Valuation Law (SVL)?
3. Might exploitation of loopholes in XXX occur, and what actions could be taken?
4. If this regulation is universally needed, why would states not directly, instead of conditionally, adopt it?
5. Will XXX lead to the creation and sale of defective insurance policies, or will XXX cause industry to build the capital it needs to support low cost term insurance?
6. Does the consumer win or lose in XXX?
7. If and when XXX is nationally adopted, what will have been accomplished?

Larry Gorski is a regulator who has been prominent in the promulgation of regulation and guidance in the area of life company valuation. Larry has been on the Life and Health Actuarial Task Force (LHATF) of the NAIC. Larry is the chief actuary for the state of Illinois, which has about a hundred domiciled life and health companies. Larry has the responsibility for overseeing about a \$100 billion of assets within these companies. Larry has been one of the developers and promoters of XXX.

Mark Oberhellman is a product development and pricing actuary. Mark started his career with Combined Insurance Company of America and then moved to Kemper. Over a six-year period, Mark was responsible for tripling the size of Kemper's term insurance business. Mark has recently moved to First Penn-Pacific Life Insurance Company where he's been for two years in their brokerage division. He is implementing a very successful program. After just one year in business, Penn-Pacific will have 45,000 low-cost term policies on the books, and Mark says that's only the start.

We have assembled two people who are very interested in the business of term insurance. Both have strong opinions about its valuation. With no further delay, I'd like to start with our first question: What is the best reserve methodology for term insurance—unitary, as specified in the SVL; segmented, as defined by XXX; some other type of defined methodology; or something more free-form, free-style methodology?

Mr. Larry M. Gorski: The way I'm going to answer this question is by turning things around a bit. What I'm going to do is look at the worst method and remove it by process of elimination. I think most people would agree that the unitary method is the worst method to deal with the problems that surfaced 10 years ago or so in the term insurance market. Even Mr. Oberhellman would say the same thing. I'm quoting from a letter that he sent to *The National Underwriter* early in 1996. I won't read the whole letter, but I'll read the relevant passage. Mr. Oberhellman writes, "Contrary to many people's claims, the unitary method is the proper interpretation of the SVL. Unfortunately, this method can produce woefully inadequate reserves under certain circumstances." So clearly he thinks the unitary method is not a very good method. It can produce "woefully inadequate reserves." They wouldn't be just inadequate reserves, but *woefully* inadequate reserves. So now we are on record and I think we can all agree that there is a problem. The question is, what's the best way to resolve the problem? The unitary method is not the way of going about it. So let's eliminate some of the other possibilities. As I do this, I'll run through the thinking of the LHATF as this process evolved.

One of things we did consider early on was to allow companies to, in effect, use their own mortality experience for the mortality basis for statutory reserves. This is a precursor to the valuation actuary idea. That idea had support from both the industry and at least some regulators, but it was too early in the game to put such significant reliance on the role of the valuation actuaries. Thus, we discounted any unfettered, unconstrained use of company experience as a basis for a mortality assumption.

We then started considering if we could develop some standards to rein in the alternative choices. We started talking about introducing requirements as to credibility on the database used for mortality experience. That seemed to have some merit. The problem was that it started separating the small companies from the large companies.

Small companies wouldn't have the same statistical base to develop their own experience. They felt they would be at a competitive disadvantage with large companies. Large companies, for the most part, supported the idea, but there was a rift in the industry.

I know some of the answers to the later questions will get into the politics of adopting a regulation. I don't think anyone's naive enough to believe that politics doesn't enter into any debate or discussion on laws and regulations. That's the fact of the matter and it's probably a good point because we do live in a democracy. We do have a chance to express alternative viewpoints, and those alternative viewpoints get through the process through political means.

So we discounted the attempt of using unfettered, unconstrained mortality experience as the basis, and we also discounted the use of some kind of credibility restrictions on mortality experience.

We then asked the Society to consider adopting or developing and promulgating mortality tables based on different underwriting requirements. I think one of the problems that people have with XXX is that the mortality assumption is still based on a standard/substandard idea. There are select factors and smoker/nonsmoker considerations, but, generally, it's still a single mortality table. We had asked the Society to develop mortality tables that took into account some of the new risk classification ideas: tobacco usage in more forms than simply smoker or nonsmoker, lifestyle, and so on. We were turned down on that request because, at that time, there simply wasn't much experience to develop the tables, and there were probably cost considerations also.

So as the process evolved, we knew immediately that the unitary method was inadequate and inappropriate. We looked at alternatives, and we finally settled on the XXX approach as it now stands as being the best approach to solving a real problem, a problem that even Mr. Oberhellman will agree to.

Mr. Herget: Mark, did you agree with any of that?

Mr. Mark J. Oberhellman: I found Larry's response about as woefully inadequate as the unitary method. Essentially, what I'd like to point out is XXX does not eliminate the unitary method. The unitary method is still going to be with us. I mean, even though it produces woefully inadequate reserves, it will produce them in the future. It's just going to be in a different form, and we'll probably discuss that a little bit later. My own personal viewpoint is I put my faith in actuaries. I believe that a valuation actuary knows more about valuing his or her business than a regulator will know. I personally favor a Canadian style or U.K. style valuation actuary approach.

What I'd like to do is examine what government regulations have given us to date. Let's actually take a look at the SVL as it stands today and see what government has given us. What we have is mortality that is the same for everybody. In other words,

guaranteed issue, simplified issue, standard underwriting, and preferred underwriting all use the same mortality. I think everybody knows they're not the same. Also, the same interest rate is used for everybody, but that's not an important factor.

What is the valuation methodology based on? It's based on guaranteed premium rates, not the premium rates that are probably going to be charged, but the premium rates that *could* be charged. And if the pattern of premiums of the guaranteed premium does not resemble that of the current, the reserves are not going to be built properly. In addition, what did we get? We got the unitary method, which is basically a fallout from the zero-lapse assumption. I think everybody knows that zero lapses is not a correct assumption either.

So what is XXX's response to the problems of SVL? What have they given us? They said we'll segment the reserve. We'll assume everybody persists until the end of a level premium period and we're going to chop them off. Nobody is there anymore.

The question I have to ask Larry is where is the solution to all the other problems in the SVL? Where is the solution for the mortality rates that are being used? Where's the solution for the zero-lapse assumption? Why are we still using guaranteed premiums instead of current premiums? Why not the premiums that are most likely to be paid? I also would even question why we're still using the SVL. I'm not a valuation actuary, but I've tried to find out how long this regulation has been around and, as near as I can figure, what we have today has been in existence for about 50 years.

Go look at the environment in which the SVL was created. Go back 50 years. What did you see? We didn't have any computers. We didn't even have any calculators. Reserves were calculated using paper and pencil. Look at the products that were sold. Almost every product was a whole life product or some variant. The actuaries were doing 20 pay, whole life, and endowment-at-65 policies. The underwriting did not vary significantly by companies. Essentially, what we have is a valuation law that is significantly out of date, one that has not kept pace with the current times. What we're doing is trying to put a patch on the system to prevent one single problem without fixing the entire problem.

I'll give you an example of a problem that segmentation will not solve. To me, the biggest concern on reserving for term insurance products is most of these term products are term to age 95 with a level premium carried for 10, 15, and 20 years. I'm concerned about the period after the level-premium period. I'm concerned about year 11 on a 10-year product, year 16 on a 15-year product, and year 21 on a 20-year product. What's the segmentation approach going to do? It's going to take

the reserve all the way during the level premium and it's going to drop it down to zero at the end of the period. Segmentation is not going to solve this problem.

Personally, I would think that we would be using some commissioner's annuity reserve valuation method (CARVM)-style approach on the reserving of this. Essentially, I look at this and see a mere patch on one of a myriad of problems that exists in the SVL. If persistency were part of the SVL, we wouldn't even have this debate right now. This is because later year sufficiencies would not be able to offset the early year deficiencies on the product. My personal feeling is they should drop XXX and move either to fix the SVL in its entirety or, as I would propose, move to the valuation actuary as quickly as possible.

Mr. Gorski: I guess there have been several points thrown out. I'll respond to at least some of them and throw a few other points on the table.

Why throw out something that has generally worked for the 50- or 60-year period that you've alluded to? The focus of the valuation law is reserve adequacy. Reserve adequacy is a big part of company solvency and, for the most part, company insolvency within the life insurance industry has not been a major issue. We have had a solvent insurance industry, and that's one of the major strong points with the public. When you buy a policy with commitments 10, 15, 20, 25, or 30 years down the road, you want to make sure that that company is there to make good on those commitments.

So the SVL has worked for the most part. And it's true, the environment has changed and there are attempts to modify, to remedy, and even to overturn the SVL, but to overturn something that has worked is probably a bit nearsighted. It needs to be done in a rational, tested fashion, which is what we're doing with the valuation actuary concept. The valuation actuary concept has been in place for four or five years now in many jurisdictions. It should take care of the promises you alluded to on the outlying years on the term policy. The build up and then release of reserves at the end of the initial segment with possible solvency concerns after that point is something that the valuation actuary should, in fact, be dealing with and considering when setting up statutory reserves.

But we can't go too quickly with the valuation actuary concept because it has not been tested across the board. It has been tested with large companies and some intermediate-sized companies, but, for the most part, the small companies have been exempted from the valuation actuary concept. These small companies are the same companies that may have an inadequate database for developing mortality assumptions. So I think we do have to consider changing the valuation framework. We have to go about it in a measured, tested fashion.

Mr. Oberhellman: Well, actually, Larry, you did not answer any questions about mortality or lapse and why those were not factored in any way.

Mr. Gorski: Yes, I did. I answered them indirectly through the—

Mr. Oberhellman: Time tested, so because—

Mr. Gorski: We can't jump over to a valuation actuary concept that would allow the judgment with respect to those assumptions you're talking about.

Mr. Oberhellman: So Canada and the U.K. are wrong?

Mr. Gorski: The U.K.—

Mr. Oberhellman: So the actuaries in the U.S. are not as good as the actuaries in Canada or the U.K.?

Mr. Gorski: Well, let's take a look at the environment in those two situations. The U.K., for the most part, sells equity-linked products. There, the valuation actuary is probably not as important with respect to the guaranteed benefit products like you have in the U.S. Secondly, the environment is probably different in Canada also. I can't speak with authority on Canada.

Mr. Oberhellman: Term-to-100 insurance is a very popular product there, by the way. No cash values.

Mr. Gorski: Well, that issue is—maybe we're getting a little bit disorganized, so I'll turn it back to you.

Mr. Oberhellman: What you have here is a situation where you've equated mortality for all companies even though mortality varies significantly by companies. You can have a company whose mortality rate is less than half of another company and yet they're being held to the same valuation standard. And it's demonstrable that their mortality is better. Everybody knows that policies lapse. Why do we have to reserve on a 20-year plan for 100% of the people being there at the end of 20 years when we know that maybe only 20% are going to be there. You don't need to be a genius to figure out that you're going to jack your reserves up doing that.

Just because we've done it that way before, I don't think that is a good reason to do it in the future. The fact is the SVL doesn't work anymore. It probably worked in the 1940s, it worked in the 1950s, it worked in the 1960s, and it probably worked pretty much through the 1970s, but it started falling apart in the 1980s. What we

haven't done is make use of the technology that we have available today, basically using the computer technology, not paper and pencil, to take advantage of that to set up more appropriate reserves for this business. Segmentation solves one problem, but it does not solve all the problems. And if you're operating in a vacuum like that, all you've done is create a whole host of other problems.

Mr. Herget: Mark, thank you for those insights. If you wouldn't care to keep your thoughts to yourself so much we could probably understand better exactly what you're thinking. I think this would be a good segue into question two. Because the debate needs more than one question, we should move onto the second question.

Mr. Gorski: We could argue this one for a while.

Mr. Herget: I think so, but the second question actually does address the SVL as well, so maybe we'll get right back into it. How can this regulation, which forgives possible deficiency reserves if guarantees are less than five years, prevail over the SVL, which would require the establishment of deficiency reserves? Mark gets to answer this one first.

Mr. Oberhellman: So Larry gets his chance to knock me down a couple times here. First, I'd like to say the SVL does not require deficiency reserves unless the premiums are guaranteed. Basically what XXX has done is trade a five-year out for a one-year out. This, I think, is a very minor concession. I think a lot has been made of the five year out, and I do not think it's as significant of a problem. Personally, I think there should be an unlimited out.

When I look at deficiency reserves, I see the exact same problems with the SVL that I see with policy reserves, only they're worse. They are exaggerated. Again, what we see is mortality is the same for everybody. Preferred underwriting equals simplified issue. Super preferred equals guaranteed issue. Everybody knows that's not true, but we're holding the same standard for everybody. Again, we have a zero-lapse assumption in the calculation. These two factors generally tend to jack up what they call the valuation net premium and, therefore, say that our premiums are deficient.

The problem with deficiency reserves, particularly under this regulation and under the SVL, is they're actually stronger than the policy reserves. Why? Because the hit is mostly upfront. Number two, they're not tax deductible. Number three, if you look at term insurance and the way reserves are calculated, these reserves can be significantly higher than the policy reserves. In fact, the largest problem with XXX implementation is not so much the increase in the policy reserves, but that if you try

to guarantee any reasonable type of premium level you will be considered deficient under this regulation.

Personally, not being a valuation actuary, I really don't understand the theory behind deficiency reserves. They seem to be a form of rate regulation. In other words, if you're a cost-effective company that has lower expenses and lower mortality, this is effectively a way to penalize you. It seems to be anti-consumer. It seems to be anti-competitive. The other thing, I don't know that I see any analogous reserves or any other liabilities that are being set up in any other institutions.

An example that I like to use is to look at a bank where you're going to go get a mortgage loan. Let's say the banking industry has now established a minimum interest rate of 8% for a 20-year loan. It doesn't matter what your cost of capital is, it doesn't matter what your expense level is. The minimum interest rate is 8%. Anything below that means you're not charging the consumer enough.

Now let's say a bank comes along and because its cost of capital is cheaper, its expenses are lower, and it wants to charge 7% for the mortgages. It's able to drop your mortgage payment from \$2,000 a month down to \$1,800 a month. Can you imagine this bank saying, "You're deficient by \$200, so we're going to make you set up a reserve of \$25,000 every time you issue a mortgage." The banking industry wouldn't do anything like that.

The insurance industry is doing it and yet sometimes we ask ourselves why can't we compete with them. I don't see other financial institutions doing this. I do not think one premium rate fits all companies. I will argue that preferred underwriting and preferred products should not be held to the same standard as a simplified issue or guaranteed issue product. Effectively, I think this is nothing more than penalizing a cost-effective company with deficiency reserves.

Mr. Herget: Larry?

Mr. Gorski: Well, I don't think Mark really answered the question. Maybe it was not a fair question for him to even have to deal with, but his response really jumped all over the place. It lacked much credibility, I guess, because it's jumping all over.

Mr. Herget: Larry, I think for Mark that was fairly concise. I've been working with Mark for a couple months getting ready for this. Mark does have a lot of ideas, as you know.

Mr. Gorski: I have an easy threshold then. There's really two ideas here I'd like to get across.

One, I believe that the current valuation law does give the commissioner quite a bit of flexibility in adopting alternative mortality standards. If you look at the definition of deficiency reserves, or minimum reserves as they're actually called, the test for deficiency reserves is based on the minimum standard of mortality. The law further goes on to say that the commissioner, by regulation, can adopt regulations that set out the minimum standard of mortality. That is, in effect, what we've done here.

We've recognized that the promulgated tables, the 1980 CSO select factors, male/female, nonsmoker/smoker variations of those tables probably don't reflect all of the underwriting considerations that are now prevalent in the term insurance market over the last 10 years or so. So what we did was develop a framework that, in effect, used implicit mortality assumptions which resulted in zero deficiency reserves for the first five years. So we've taken into account the very things you've alluded to as shortcomings in the regulatory framework by explicitly considering them and implicitly building them into the regulations. So we have a regulation that, I think, deals with the majority of considerations that you threw out on the table.

Mr. Oberhellman: Alternative mortality standards—are you suggesting that Illinois or some other states would adopt mortality standards that are lower than what's in the XXX regulation, or are you just assuming that the five year out is the concession that is made?

Mr. Gorski: The way the framework works is, the NAIC has to adopt a table and then that table is adopted by individual states. The NAIC has adopted a regulation that allows for a more liberal treatment of deficiency reserves in certain situations. That more liberal treatment, one could assume, is built on an implicit mortality table that, in effect, would develop net premiums that would not generate deficiency reserves. So let's say it may be a circuitous argument. I'm not going to say it's straightforward, but it's no more circuitous than many arguments I've heard from the industry on other issues. It's something that gets the job done.

Mr. Oberhellman: Is there a means to alleviate the deficiency reserves that would be caused by this regulation for guaranteed premium products?

Mr. Gorski: If the SOA would conduct a mortality study that would reflect current underwriting and risk classification schemes and that table passed the peer review process and—

Mr. Oberhellman: But as of this moment there exists nothing?

Mr. Gorski: As of this moment there exists nothing.

Mr. Oberhellman: There is no means whatsoever to alleviate the deficiency reserves that would be caused by this. If you look at term insurance premiums that exist today and you try to guarantee them under XXX, you are going to cause deficiency reserves beyond belief. The reserves will go through the roof. You can look at it. I've seen first-year reserves, as a result of deficiency reserves, that would increase your current reserves by 50 times or more. And these premiums, I will argue, are not deficient. The reason they're considered deficient is because the mortality assumption that is being used is grossly overstated, as well as the fact that they've used a zero-lapse assumption. These have been used to drive up what they are saying is the valuation net premium. These assumptions bear no resemblance to reality and there is no means in the regulation to alleviate that.

Mr. Gorski: So far we haven't had the tables developed that would allow us to replace impressions with facts. We have no generally accepted mortality tables that reflect the mortality that could be assumed to occur under the different classification schemes. We would simply be using impressions instead of facts if we went the route you're suggesting.

Mr. Oberhellman: So technology here has outstripped our information. Back when this regulation started in 1989, preferred underwriting was in its infancy. You probably had two or three years of experience on those products. Now you can get probably eight to ten years worth of credible experience on preferred underwriting, yet it has not been done and probably will not be done any time soon.

And yet what will happen is this regulation will be enacted without a means to alleviate these problems. Again, we're still concentrating on the mortality issue. The zero-lapse assumption is also a significant problem. If we go back and look at the SVL and whole life insurance, you'd see there wasn't a problem. You had cash surrender values, so the fact is it didn't change things all that much. But for a term insurance problem, the lapse assumption is a significant problem. It is a significant problem.

Mr. Gorski: Well, let's deal with mortality and lapse assumptions. Early on you had suggested that CARVM would be a better approach than XXX. Yet CARVM also relies on a zero lapse.

Mr. Oberhellman: Wait a minute, let's back up. First, my answer was simplistic. I'm not going to get down in the minutia here, okay. By CARVM style, what I

meant is to go forward and look at each period of time and not try to artificially segment it. And I would still use some form of persistency or lapse in determining what the reserve would be. The fact that CARVM for annuities doesn't include that is a different matter.

What I'm simply saying is, do not just sit there and artificially truncate. I would look at all future premiums. I would look at all future periods and basically try to take the greatest reserve.

But that, again, is not jumping around. We have a small forum here in which to present our ideas, and it's very tough to present everything that's cohesive and lay everything out exactly.

Mr. Herget: Larry, why don't you give a one- or two-sentence answer, and I'll move onto the third question.

Mr. Gorski: Just quickly looking at CARVM, you said look at the greatest of all possible reserves. To do that assumes a 100% lapse assumption, so I think that takes care of the lapse issue on the mortality side. If you or anyone else either individually or as a group is willing to develop mortality tables that reflect the different classification schemes, the NAIC and the states would be more than willing to consider those mortality tables as part of regulation XXX, because the mechanism is in place to adopt alternative mortality tables.

Mr. Oberhellman: Well, I would argue that we need concurrent adoption.

Mr. Herget: Let's go to number three. Probably the answer to the first part is pretty easy, but the second part is quite intriguing. Might exploitation of loopholes in XXX occur, and what action might be taken to combat it?

Mr. Gorski: I'll try to keep my response brief. I'm glad you recognize that the question is rhetorical. Yes, exploitation will take place. There's no question about that. The exploitation will probably result in a regulatory response in three different areas.

One avenue of response may be through the valuation actuary concept, which is already applicable for large companies. So if the exploitation results in what is perceived to be deficient reserves, there's that avenue to be taken. In the case of a Section Seven (actuarial opinion) company, which is not subject to asset adequacy analysis, a regulator, if he or she feels that there is a reserve problem, can require a Section Eight (an asset adequacy analysis and opinion). So if the exploitation results

in what's perceived to be a reserve adequacy solvency concern, I think there's a mechanism in place for dealing with that.

If it's a more fundamental-type exploitation, the life illustration regulation, which is starting to be adopted in many states, may be an avenue for regulators to explore. In the first place, companies will have to develop illustrations for these products. If actual performance differs from what's illustrated for reasons other than changes in experience, then there is recourse under the illustration regulation.

Maybe the most Draconian of all ways of dealing with the problem is if there is overt manipulation or problems with the advertising of the product. Illinois, like other states, has on its books in the statute the ability to not approve policy forms on several bases. If the policy form is perceived to be misleading, ambiguous, or abusive in other ill-defined ways, the policy form may not be approved. So I think there is ample regulatory ammunition to deal with exploitation problems. It's simply a matter of regulatory will to use those different techniques. And if the problem is widespread enough, we're back into the current situation of adopting fixes to the valuation law and regulation XXX. So I think there are ways of dealing with exploitation.

Mr. Oberhellman: Personally I don't think there would be a reserving problem, even for exploitation, if the valuation actuary were allowed to set appropriate reserves. But I could not agree with Larry more; I think exploitation will occur. I think that's one of the reasons you see XXX right now. I think this is the area where Larry and I do agree. I think there's a basic viewpoint right now that exploitation is taking place under the current valuation law, if we see how long the regulatory response has taken before they've actually had an answer for this. XXX has been kicked around since 1989. It still has not been adopted. I don't know that we're going to have this in place January 1, 1997, but maybe there's a good chance by January 1, 1998. I think companies will take advantage of this.

What I personally see as the biggest loophole in this regulation, and it exists under the current SVL, is not the five-year out, but the fact that reserves are based on guaranteed premium rates. In many cases what you have is guaranteed premium rates whose pattern will bear no relationship whatsoever to the current premium rates.

Popular products now are term to age 95 with a level premium period of 10, 15, or 20 years. What I think you're going to see happen is these products are going to not be guaranteed for 10, 15, and 20 years. They're going to cut the guarantee back to five years and essentially you're going to get a guaranteed scale that rides up the 1980 CSO, which will effectively end up, as long as the actuary is careful, resulting

in unitary reserves. You'll effectively be able to avoid the deficiency reserves and we will end up right back where we are today. We'll have unitary reserves. The difference, or the trade-off that will be made, is trading 10-, 15-, and 20-year guarantees for a five-year guarantee. This is probably going to be the single, biggest exploitation that I think will exist if this regulation is adopted.

Maybe Larry can help explain what I don't understand because he was involved in these committees in determining this regulation. Say you take one of these products, term to age 95, with a level premium for 20 years. Then you have two products with exactly the same premium rates. One product is a five-year guarantee, the other product is a 20-year guarantee. XXX is now adopted. How can you justify the differential in reserves that will exist between those products? How can you justify not only just the differential, but also the pattern of reserves that will exist between those products?

One of the products is going to be reserved largely, at least in year six or later, under the unitary method that exists today. The other product is going to build the XXX-style reserves that they're seeking and they will have a fairly large increase in policy reserves. If the premiums aren't increased significantly, there will be a substantial deficiency reserve. From where I sit as a product actuary I just cannot justify the differential that I would see in the reserves.

Mr. Gorski: I think the one glaring omission in Mark's analysis of the situation, and I guess I'm surprised that this is an omission, is that guarantees cost. When an insurer makes a guarantee to a policyholder, that is fundamentally different than a situation where there is a nonguaranteed element. Guarantees cost; guarantees generate risk. Risks need to be reserved for. So in my mind, there is a very clear explanation why the two different designs you've discussed have different levels of reserves and different patterns of reserves. Guarantees cost. They need to be considered in the valuation framework.

Mr. Oberhellman: The problem is not that it costs, it's how much it costs. You're saying that unitary reserves are woefully inadequate today, and what I'm telling you is that if you guarantee it for five years under this product and you guarantee it in an ART scale, you can get virtually the same reserves. If they're woefully inadequate today, they're woefully inadequate under XXX. The difference is the guarantee.

The premium will be virtually the same and yet if I guarantee it, I'll get policy reserves that could be 10 times higher at some durations. I could get deficiency reserves that will take reserves up 50 times. It's not the cost. It's how much it costs. You are still allowing products to be inadequately reserved under XXX. The

difference is if I don't guarantee it, I don't have to reserve for it, so it still exists. Unitary still exists.

Mr. Gorski: I'm not sure how you could logically argue that we're permitting reserves to be inadequate under XXX where, in fact, we have the valuation actuary concept which puts the burden of adequate reserves on the valuation actuaries.

Mr. Oberhellman: It exists today. Valuation actuaries do it today. The burden is right there. If the reserves are inadequate the valuation actuary is charged today. XXX does not change that.

Mr. Herget: We have done a good job of exposing two sides to that argument. I would like to move to question number four. Mark, you will get to take this first. If this regulation is universally needed, why would states not directly, instead of conditionally, adopt it?

Mr. Oberhellman: Actually this is a tough question for me to answer because I don't think the regulation is needed. I obviously think some regulation or change is needed, but I do not think this regulation is needed. I get back to my point before: I think we need to overhaul the SVL and bring it into the 20th century. We need to change the mortality assumptions that are in it, incorporate lapse assumptions, and base the reserves on current premiums instead of guaranteed premiums. Then we wouldn't have the problem that I just alluded to about the differential in reserves between guaranteed premium products and nonguaranteed premium products.

Mr. Herget: Mark, take a look at the direct versus conditional aspect of this question.

Mr. Oberhellman: Essentially I would say the 51% shows that the regulation is not needed. I think what this is alluding to is Illinois has contingently adopted this regulation assuming that states with 51% of the population end up adopting it. I don't think that solvency is something you compromise, despite how your domestic insurance companies may be affected by the regulation. If I were in Larry's shoes, and I truly believed that we had insolvencies sitting on the horizon because companies were inadequately reserved, I would pass this regulation regardless of what other states did.

Mr. Herget: Mark, we're going to cover that in question five, so let me give Larry an opportunity to respond.

Mr. Oberhellman: I would like to ask some other questions here though because there are other aspects of this regulation that I think show that it is not needed.

Mr. Gorski: Well, in the first place, we did not conditionally adopt the regulation. We adopted the regulation. We made that perfectly clear to the world and we went through the whole formal process of adopting the regulation. We had two public readings and then our hearing on Regulation XXX. It was adopted. There is a contingent effective date, but there's no condition about adopting a regulation. It is adopted.

I hear someone chuckling. It was done intentionally that way. We gave a sign to other states that, yes, in fact, we're serious about Regulation XXX. We don't believe that insolvencies are going to take place overnight, so we're willing to let other states get on board. Other states are getting on board with the very same approach we're taking. As soon as we adopted the regulation in the form that we did I received phone calls from Iowa and from New Mexico. I've heard Indiana and possibly Maine are taking the same route as we have. It gives smaller states the opportunity to adopt a regulation and not put their companies at a competitive disadvantage.

Again, I don't think an insolvency would take place overnight and so regulatory action in this area is not needed immediately. It's important to get it done in a reasonable period of time. This gives everyone a clear signal as to what we're doing, why we're doing it, and it allows everyone to get on board.

Mr. Oberhellman: I'd like to point out that this regulation has existed for seven years, and I don't think one company that has sold term insurance has become insolvent during this period of time. So I agree with Larry, they do not occur overnight, but apparently they don't occur over a seven-year period of time as well. One thing I would like to point out, and maybe Larry can answer this, is he needs states with 51% of the population to adopt this regulation. If they do not get that, that means this regulation will never be adopted. If it is so badly needed, why would you be prepared to wait indefinitely or perhaps never have it adopted if solvency is truly the issue?

Mr. Gorski: Interesting question. I have a good answer for that. The NAIC is working on the codification process, and you may or may not be knowledgeable of that. Basically, the codification process is an attempt to, in one framework, codify all statutory accounting requirements including reserve requirements. It's going to become the basis for the CPA audit of a company's statutory books and records. A part of that codification process is an enumeration of the laws and regulations that need to be consulted if the answer to a specific question is not in the accounting documents. The list or the hierarchy, as it's called, of the laws and regulations that are part of the codification process is regulation XXX. So it's anticipated, if everything moves along in the fashion that it has been going on for a couple years

now, that regulation XXX actually will be a part of each and every state's accounting requirements.

Mr. Oberhellman: Yes, but the question is you're not going to make it effective in your state until you get states with 51% of the population, is that correct?

Mr. Gorski: That is correct.

Mr. Oberhellman: That is the language that many states appear to be moving towards. The question was, why are you willing to wait indefinitely to adopt this regulation? I would say that there are not enough states on board as of today to get the 51%. I'm not going to say that doesn't mean it's not going to happen in 1997, or 1998, or 1999. But the fact is, if solvency is a problem, if it truly is a problem and it exists today, why would you be willing to wait potentially indefinitely to make this regulation effective? As a regulator you are telling me that the reserves are, as you agreed with my letter, woefully inadequate. Why would you be willing to wait one year, two years, three years? You've already waited seven years.

Mr. Herget: Larry, answer that question and we'll move to the next question.

Mr. Gorski: Because I don't believe I'm waiting indefinitely. I believe a codification process will take care of the problem in two or three years from now anyway. What we're doing in Illinois is simply giving a signal to everyone right now. We believe in Regulation XXX, and if that doesn't get other states on board, the codification process will. So I don't believe we're delaying an important issue.

Mr. Herget: Okay, the next question does lead us into more surplus issues. Will XXX lead to the creation and sale of defective insurance policies, or will XXX cause the industry to build the capital it needs to support low-cost term insurance? The question goes to Larry.

Mr. Gorski: Thank you. The use of the word "defective" is very inflammatory. I'm not going to get into all the details as to who first started using this word, but clearly the use of the word "defective" has created much discussion in regulatory circles. The first point I want to make is that regulation XXX is not causing any insurance company to issue and administer defective policies. If there are going to be any defective policies it's because of the insurance industry and the actuaries who work for the companies. It's not because of Regulation XXX. It's the companies and their actuaries who will make policies defective.

The basis of this argument is that any policy with a nonguaranteed element is in some way defective. That's the essence of this argument. You're dealing with

policies that will probably have five-year premium guarantees, followed by a very large premium in the out years with the hope of a current premium still being competitive. So the issue surrounds itself on this current premium beyond a guarantee period and the possibility of that being somehow manipulated or abused by companies.

If that's the case, and if you believe the argument, then you probably also believe that universal life products are defective. You'll probably also believe that deferred annuities are defective because they all contain nonguaranteed elements. Heck, you probably believe that participating policies are defective and most of accident and health insurance is defective. And if you're a regulator and you believe all that, you might as well shut the insurance industry down right now, because everything is defective according to the people who use the word "defective" in conjunction with term policies post-XXX.

I don't believe all policies are defective. I don't believe that the insurance industry needs to be shut down. There are some bad apples. We do have regulations that attempt to deal with that. The illustration regulation is a good example of that. It will deal directly with some of the exploitation and abuse issues that probably will surface after XXX is adopted.

Mr. Oberhellman: I won't get into the defective policy issue basically because I agree with Larry on this. I do not believe that those products are defective. I think it is an inflammatory term that has been used in some cases inappropriately. I know the individual who started that; I believe he is prone to a little bit of hyperbole.

I will concentrate instead on whether it's going to build capital or not. First, I would like to point out that there are large blocks of business that are not going to be covered by this regulation, at least in terms of building the reserves.

Second, despite how much this regulation is needed to head off insolvencies, the regulation is not retroactive, so all existing policies have been grandfathered. Further, reentries have been grandfathered as well. So if you have the contractual right to reenter, say a policy reenters 10, 20, 30, or 40 years from now, it is not subject to XXX reserves. In addition, if you don't guarantee the premium, as I pointed out earlier, essentially you're back to where you stand today. XXX-style reserves will only apply to new business with premium guarantees. New business with shorter guarantees will effectively have old reserves.

This will beg a question: will policies with longer premium guarantees sell? Will the public buy them and, as a result of buying them, will we see higher premium rates and higher reserves? I do not believe the public will be willing to pay for the

cost of the premium increase because, as I stated earlier, the reserves that would have to be set up for the premium increase or the amount by which the premiums would have to be increased are excessive.

I don't have exact figures for this, but I would say a ten-year guarantee will cost somewhere between 10% and 30% in additional premiums. A 15-year guarantee will probably cost a 20–60% increase in premium. A 20-year guarantee will cost an additional 40–120% increase in premium.

My numbers are probably not exact, and everybody has different figures. But, being as it may, the amount of premium increase needed to offset the reserve increase is exorbitant. I think what you're going to see is the consumer, when given the choice, is going to buy ART insurance. He's going to buy five-year term. He's going to buy 10-, 15-, to 20-year term with premiums guaranteed for five years. I think probably you'll then see some form of back-door guarantees put on these products with the five-year guarantees. I think you may see conditional premium increases on these products as well. But I do not think you will see a substantial portion of the term insurance business sold in this country with long-term guarantees. Without the long-term guarantees, you will not get an increase in reserves over what you see today. There will be some, but I do not believe it will be significant.

I would also like to point out, even though I'm getting off the topic here, Tom, that there is one element in XXX that I think has an antisolvency feature. I think that you'll see that ART insurance is favored by this regulation. ART insurance will basically have reserves that will stay the same or will be lowered as a result of this. The experience that I have seen on ART insurance versus level term insurance is that the mortality experience is 30–40% higher even though the underwriting is exactly the same. I personally do not want to see a return to ART insurance, which I believe this regulation favors, which would also not deal with the capital adequacy.

Mr. Herget: Larry, you have equivalent leeway.

Mr. Gorski: I also believe that capital will not be built under this regulation. I believe the trend in product design is as Mark had indicated. I don't see too many companies either coming into the market with higher-cost products, and I can't argue with the intervals suggested by you. That's probably as close as anything else I've heard. I don't see companies biting the bullet on pricing and simply absorbing the surplus strain, so I see the trend in product development probably the same way you do.

Mr. Oberhellman: So you see guarantees going to five years?

Mr. Gorski: Definitely.

Mr. Oberhellman: So as a result of this, you see guarantees going to five years, premiums not increasing substantially, and the reserves not increasing substantially. You'd say that you think that this will become more the norm if this regulation is adopted?

Mr. Gorski: At least in the short term, yes.

Mr. Oberhellman: If this happens, this regulation basically will, instead of increasing reserves or increasing the capital, result in shorter premium guarantees. Are you satisfied you did the right thing by passing this regulation?

Mr. Gorski: Well, that's the next question: will the consumer win or lose?

Mr. Herget: I think that is a good observation and let's just answer that. Let's go right to question number six. Does the consumer win or lose with XXX?

Mr. Gorski: I think Mark was supposed to start with this, but I think the ball's in my court.

Mr. Oberhellman: Obviously, I think consumers clearly lose with this regulation. I am not up here arguing for the company. I think consumers will clearly lose here. I think what they're going to be faced with is that they can get premium rates that are comparable to what they have today, but they're going to have to accept lower premium guarantees. Or, they can get similar guarantees, but they're going to have to pay significantly higher premiums—20%, 40%, 60%, 80%, or 100% higher.

I think the basic problem with this regulation is the reserve level that's being set up—policy reserves—but largely deficiency reserves as well. I think the cost for the premium guarantee that is set by this regulation is too high. I don't think a 20-year guarantee should cost a 100% increase in premium—10% maybe, but not 100%.

One thing that I'd like to point out is what this regulation is going to do. It's going to take pricing risk and it's going to pass it to the consumer. Low-cost term insurance under this regulation will have a five-year guarantee, no question about it. The cheapest insurance that you can buy will have a five-year guarantee.

Let's scenario test what happens today. When I sit down and I price out a product I know that if I make a mistake and I underprice that product, my company is going to be the one that pays for it down the road. The first hit is going to be to the

company. Why? Because the premiums are guaranteed. So if I do a bad job, my company's going to pay for it first.

The next level of defense should be the state guarantee fund. Finally, the consumer will be the last in line. If this regulation is adopted and I make a pricing mistake, what you will see is those with five-year guarantees are paying for my mistake. The consumer is going to pay for it first, because he's going to get hit with a premium increase. Then the company's going to pay for it. Finally, there's the state guarantee fund.

So what I find surprising is the support of this regulation if supporters truly think that right now we're underreserving and underpricing for this insurance. I must tell you that underreserving and underpricing is going to exist under this regulation. But what's going to happen is it's going to exist with products with five-year guarantees. Who's to pay for it if they're right? If Larry and proponents of this regulation are right and we're underpricing and underreserving, the consumer is going to be the one who's socked down the road. If they're wrong about it, I think you can argue that you don't need the regulation.

And there's another antisolvency aspect of this regulation. Look at the term insurance marketplace right now. Many people are concerned about the term insurance wars. Yet when these pricing actuaries sit down and they price their product, they know that if they make a mistake their company's going to pay for it.

Imagine what would happen in a term insurance marketplace if you released the shackles of the premium guarantee and you cut it back to a five-year guarantee. Do you think the term wars are going to heat up or do you think they're going to cool down? I'll tell you with a five-year guarantee they're going to heat up. You'd think there's a fire sale going on in term insurance. This regulation is going to throw kerosene on that fire.

Mr. Gorski: In your comments, Mark, I did hear a hint of humility. I did hear something to the effect that maybe pricing actuaries *do* make mistakes. It was a little different than I heard in your response to the first few questions. So there is the possibility of a pricing actuary making a mistake. That's our concern.

We do look out after the consumer interest. Pricing actuaries have made mistakes and they will continue to make mistakes. In the term insurance market, policyholders are buying large face amount policies well in excess of guarantee fund limits. So there could, in fact, be real damage to policyholders. I believe that this regulation is in the consumer interest because it does enhance solvency, which *is* a major part of our concern.

Mr. Oberhellman: By passing unexpected premium increases to them down the road if the pricing actuary makes the mistake? Why not just make him set up higher reserves as this regulation was intended to do?

Mr. Gorski: Let's back up a second. When you were talking about whether the consumer wins or loses, I think you mentioned something about a windfall price increase at the end of the five-year guarantee period as making the consumer lose. Well, in fact, if that price increase is due to change in experience, then I think the best thing is being done. In fact, the true cost of the coverage is being borne by the policyholder. If, in fact, that premium increase is unnecessary because experience has not deviated, then if there is a premium increase on the part of the company, that is something they're going to have to live with. And, in fact, they probably won't live very long. This is because, one, they will be violating the illustration regulation. Two, there will probably be lawsuits following as a result of that. Three, word gets around pretty quickly now about companies that play games with policyholders. So I think the consumer does win under Regulation XXX.

Mr. Oberhellman: In other words, it's okay for somebody to lower their premiums to garner market share, and if they're wrong pass the premium increase because their expectations weren't realized. I would look at that as some form of bait and switch.

I personally think there should be some level of comfort drawn by Larry and the regulators about the fact that they know that if they make a mistake a company's going to pay for it. What about some companies that sit there and look at term insurance and say, "We don't know how they're doing it, but now we only have a five-year guarantee? We'll get into the market and we'll see if we can do it, too. If we're wrong, we'll just increase the premium rates down the road to the consumer."

I agree with Larry in that there will be pressure on companies to maintain their rates. In other words, there will be pressure on term insurance companies who want to remain viable in the long term selling in a market, and that they will have a great deal of pressure never to increase their premium rates. Unfortunately, and Larry knows this as well, there have been plenty of companies that have jumped into the term insurance market that have also jumped *out* of the term insurance market. They don't have that constraint put on them. There's probably just as many companies that used to sell term insurance as sell term insurance now.

I think with the consolidation that we see in the industry there must be some concern about companies where there are mergers and acquisitions occurring. I think we already had instances where policyholders probably have not been treated, what I would consider, 100% fairly when the company they bought their

policy from has been acquired by another company that, for means of profit and boosting shareholder equity, has decided to change their expectations slightly.

Mr. Herget: Let's proceed to the seventh and final prepared question. If and when XXX is nationally adopted, what will have been accomplished? Larry?

Mr. Gorski: First, a real problem will have been solved. A problem that I think everyone recognizes (even Mark) is that the current unitary reserves are woefully inadequate. That problem will have been resolved. I think Mark probably disagrees with the validity of that as a solution, but I'd like to quote from a few other sources that may take a different view.

The solution is consistent with existing statutory valuation requirements for other forms of life insurance. I think we all have to agree that the valuation framework that has been in place has done a good job over the years in which it has been in place. This statement is one of the key conclusions of the November 28, 1995, letter from Mr. Randall P. Mire, Chairperson of the Committee On Life Insurance of the American Academy of Actuaries.

The direct quote is, "It [the segmentation approach or regulation XXX] provides a reasonable interpretation of the statutory reserving method for certain types of policies, i.e., term policies with level premium guarantees. It also reserves these policies in a similar manner and at a consistent level as the other policies covered by the CRVM."

So, one, it solves the problem, a real problem. Two, it solves a problem in a fashion consistent with the application of the reserving methods of other lines of business and with a method that had proved successful generally for over 50 or 60 years. If the regulation is adopted on a nationwide basis, it reinforces the idea that guarantees create risks and risks need to be evaluated and reserved for.

Here is another quote from that same November 28th letter and it says, "From a solvency perspective, it provides better protection for insureds and insurers than previous interpretations." So I think it reinforces my view that Regulation XXX is in the best interest of the consumers, and, second, there's a great deal to be accomplished by adopting that regulation.

Mr. Herget: Mark, what's your viewpoint?

Mr. Oberhellman: First, I'd like to address some of the points that Larry has made here. Better protection for consumers has been provided in the form of lower premium guarantees, not in higher reserves. Larry basically has said that. I do not

think lower premium guarantees are better protection for consumers. Personally, I think if a company misprices a product they should be the first line of defense and not the consumer. I think it is wrong for us to think that, because a company does something wrong, it's okay to pass the risk. This regulation will pass pricing risk onto the consumer.

Additionally, what I'd like to point out is the reserving issue here has not been addressed, and Larry has basically admitted to some of this. Bottom line is this regulation does not apply to retroactive business. It does not apply to any in-force business. So the reserves in that business are not going to be increased. Reentries are grandfathered as well; the reserves on that business are not going to be increased. If you don't guarantee the premium rates on new business, their reserves are not going to be increased.

There's only one specific group of policies that will have a change and that is new policies with long-term guarantees, which, I think as Larry pointed out, the public is not going to buy. So reserves and the capital are not going to be built on this regulation.

Larry has also pointed out he thinks the valuation framework that has worked for 50 years is fine. What I tried to point out today is the valuation framework does not work anymore, if for no other reason than in the underwriting differentiation that exists by companies.

I would like to read something that also came out of the Life Practice Council of which Larry is a member. It addresses comments very similar to what Larry has said. "Because of the above considerations and the responsibility faced by its members, the Academy strongly urges you to take the following two actions. One, adopt the model regulation with minimal variation as of January 1, 1997, applicable to all new business written on or after that date."

And here's item number two. "With respect to in-force term insurance policies, continue to accept statutory formula reserves that were accepted on any annual statement covering periods prior to January 1, 1997, provided the appointed actuary offers a specific opinion as to the adequacy of reserves backed by the appropriate gross premium valuations."

I think that would also probably apply to reentry business, as well as policies that don't have guaranteed premiums after the policies are in force. Why isn't it good enough for policies that are guaranteed as well? If a valuation actuary attests to reserve adequacy, why isn't that sound? If it's good for all these other blocks of business, why wouldn't it be good for this very small block?

Addressing if it's adopted nationally, I think the consumer is going to lose significantly on this. Why? Because what do they get for this? They're going to get a policy. They'll get two choices. They'll get two basic choices. They will get policies with premium rates similar to today's with shorter guarantees or they can get the long-term guarantee for a much higher price.

I pointed out the prices that they're charging and the reserve differentials here. The reserve differentials that are being set up between guaranteed products and nonguaranteed products under this regulation makes it a situation where the premium increase is exorbitant. You should not have to pay a 100% increase in your premium rate for a 20-year guarantee. The reserves are too high.

Mr. Gorski: Again, there are several points I'd like to comment on. You point to the Life Practice Council letter and particularly that second point about dealing with in-force policies. It is true the regulation only applies to policies issued after the effective date of the regulation. I think that's the way it should be. We live in a country that doesn't change rules retroactively. It would be nice in some cases to say, yes, we can go back and change rules from day one, but I think that's a somewhat dangerous precedent. Even though I may not completely agree with the idea, I think everyone should be treated fairly in this country.

Mr. Oberhellman: Larry, if you polled the term insurance companies to eliminate the deficiency reserve, bring preferred mortality assumptions into the reserve calculation, and bring some reasonable level of lapsation into the policy reserves, I would be willing to bet that most term insurance companies would be willing to hold those higher reserves. If you did those three things, I'll bet you most companies would be willing to make it retroactive. If you get rid of the deficiency reserves, get realistic mortality, and get some type of reasonable lapsation into the valuation, they would be willing to set up higher reserves on existing business. I think this would be better for the industry overall than the unitary method that exists today.

Mr. Gorski: I would probably be willing to do most of those things if, one, you define for me what's meant by reasonable lapsation. We can probably argue ad infinitum on that. Second, are you volunteering to put together the preferred risk mortality tables that we, in fact, have asked for and have not seen produced?

Mr. Herget: I would like to interject and say our debaters here have anticipated what the audience is thinking. We do have questions from the audience and, believe it or not, two of these questions have been asked. I want to give the audience credit for keeping up with Larry and Mark. One question is, if lapse assumptions are included, how can we monitor what is appropriate? Along the

same vein, how does liberalizing mortality and lapse assumptions further ensure company solvency for all policyholders?

Mr. Oberhellman: May I answer that? I am not advocating using nonconservative assumptions. I would use conservative lapse rates. I think it should be prescribed that we use conservative lapse rates. The same thing is true with mortality. I am not advocating using nonconservative mortality.

I want to take an example from this regulation—the 15-year select factors. This is a clear example that has been added as a means to get updated mortality. What were the experience years used, 1983 or 1986, somewhere in there? So we're already a good 10 years out of date. And when was that business written? It was written in all the years prior. So what existed back then? Much of that experience is 15 or 20 years old.

So mortality experience is already 15 to 20 years out of date. You can project that forward and get at least a 10% improvement in mortality. Most of that business was nonmedically examined business. If you look at term insurance today, everybody is getting a full blood profile. Tests that didn't even exist back when this experience was measured are now used to determine preferred mortality. It is not unreasonable to assume that the mortality that people experienced on their preferred term business is actually half of what was contained in the experience that was observed in 1983–86.

I think there are companies out there that show mortality that would probably be in line with what I'm saying. What does this regulation require? It requires we use 120% of that mortality, and 150% for deficiency reserves. So they said even though this mortality is all out of date, it's still not conservative enough. That is what I have a problem with. It's the level of conservatism that's in there. When is enough enough?

Mr. Gorski: Well, the person from the audience who raised the question on lapse is right on target. How does one determine what is a reasonable lapse assumption? We've argued that point in many different forms in the past. It's a very subjective answer. While Mark clearly is on the side of conservatism, his definition of conservatism might be completely different than someone else's definition of conservatism. He is on the left. You need to remember that.

Mr. Oberhellman: Larry from the right. We've got cross fire going on here.

Mr. Herget: Tell me.

Mr. Oberhellman: No, but, Larry, there are examples. If you look at Canada, they do have term to age 100. They have guidelines that are set up there; I don't remember exactly what they are. But I have personally never, even on level premium term, seen a lapse rate on a term policy lower than 6%. I've watched in my years with my former company. I watched lapse rates go down.

Would it be wrong to assume an ultimate lapse rate of 2% or 3%? I don't think so, but what we're doing right now is we're assuming everybody sticks around except for those that die. You will see lapse rates on level term that will start out around 10% and, from what I've seen, will drift down to around 5%. I'm not advocating starting at 10% and drifting down to 5%. What I'm saying is we ought to at least incorporate some level of lapsation in there. On a 20-year term plan, we're assuming 100% of the people are going to be there at the end of 20 years, but if you use conservative lapse rates you would get less than 50% of the people being there. It will make a significant impact in your policy reserves as well as your deficiency reserves.

Mr. Gorski: I think it was the second part to the question dealing with the mortality assumption. I think Mark pointed out some of the conservatism in the assumptions underlying Regulation XXX. They are conservative. There's no question about that. The point is, though, in trying to get more realistic assumptions we need more current experience. We need experience by different underwriting class, and so on, and that experience is not there on a uniform, standard basis.

Mr. Oberhellman: Do you really believe that it's ever going to be there? Look at preferred underwriting as it exists today. How can you go out in the marketplace and get term insurance companies? Everybody's preferred class is different, and everybody has preferred. People do lifestyle underwriting. Many people concentrate on their basic health, personal history, and family history. It's impossible to get consistency on that.

As actuaries, we all know that simplified issue where they asked five questions and had no blood profile is not going to experience the same mortality as preferred. Yet they are being held to the exact same standards. The differential in mortality is huge. My company can't look at this because we're relatively new. But some of the older companies that have been selling preferred business since 1987 or 1988 could probably show that their mortality experience is significantly below. That was part of the original XXX, if you remember, Larry. It had allowed a company to show its experience and to be able to, at least on the deficiency reserves, take that rate down. Why can't a company use its experience that it has and allow that flexibility? Why couldn't that have been built into the regulation? Why was it pulled out?

Mr. Herget: I think we are starting to run out of time, so I'd like to ask each panelist to prepare a few closing remarks. I'd like to say there are two workshops on XXX that address some of the program's items, such as the status, special features, and so on.

Mr. Oberhellman: First, I'd like to thank Larry for agreeing to come up here and debate. I don't know if you enjoyed it or got anything out of this, but, as far as I'm aware, this is the first time there has been an open discussion about an issue like this. I'm very grateful for the opportunity to come up here and express some views, views that I think are contrary to what I think many actuaries who have not been close to this issue have heard. Larry didn't have to do this and, basically, I just appreciate the opportunity to express my views.

Mr. Gorski: Although I didn't have to do this, I actually enjoy doing this. In summary though, I think we have to look at the fact that everyone recognizes that there is a real problem. XXX may not be the best solution. Mark has problems with XXX. I think everyone probably has some difficulty with some aspect of XXX as a solution to the problem. But if you start running through the alternative solutions, you come to the belief that XXX is probably the best thing that could be done to solve a real problem. So that's why I support XXX, why our department supports XXX, and why we think it's in the best interest of the insurance public and the insurance industry.