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ATTACHMENT FOUR-A

TASK FORCE REPORT OF THE SUBCOMMITTEE ON COST COMPARISONS

September 2, 1980

The purpose of this report is to recommend (1) certain clarifications in the cost disclosure applicable to special plans; and (2) introduction of a "Non-Guaranteed Element" concept into the NAIC Life Insurance Solicitation Regulation and Buyers Guide. These refinements are needed to provide fair cost disclosure for products which have emerged in recent years and which differ in some respect from the more traditional life insurance policies.

"Non-Guaranteed Element" Index (NGE)

The NGE would replace ELAD and would be determined for ten and 20 year periods. For a given period of years, the NGE would equal the difference between (1) the surrender cost index determined on the "highest possible cost" basis; and (2) the surrender cost index on the currently illustrated basis.

For traditional participating policies, the "highest possible cost" basis would assume no dividends. For "adjustable premium" non-participating policies, which contain the contractual right to decrease or increase premiums within maximum limits set forth in the policy, the "highest possible cost" basis would assume maximum premiums during any period beyond the time when the initial rate level might be guaranteed. For other special types of policies (i.e., "adjustable cash value" policies, the "highest possible cost" basis would assume minimum contractual cash values and death benefits.

One feature of the ELAD approach, incorporated in the current NAIC Model Regulation, is that it does not include terminal dividends. The NGE calculation does incorporate terminal dividends, and thus the NGE index does specifically define the non-guaranteed element of the surrender cost index.

For most plans, the NGE defines the non-guaranteed element of the payment index, as well. However, we recognize that there are some plans for which an NGE based on the payment index might differ significantly from the NGE based on the surrender cost index. As noted above, such situations now exist with ELAD under the current regulations. For these situations, an amended regulation should allow the insurer to disclose both types of NGE.

Economatic, or "EOL", type policies

For cost disclosure purposes, let us define an EOL-type policy as a participating policy which as the following characteristics for all issue ages:

1) The basic policy has a guaranteed death benefit, which reduces after an initial period of one or more years to a basic amount.

2) A special dividend option provides either (i) a combination of immediate paid-up additions and one year term insurance; or (ii) deferred paid-up additions, which on the basis of the current dividend scale will provide a combined death benefit (reduced basic death benefit, plus paid-up additions, plus one year term) at least equal to the policy's initial face amount.

In this regard, let us define "cross-over" point to mean the first policy anniversary at which the sum of the reduced basic death benefit and paid-up additions equals or exceeds the initial death benefit.

In calculating cost indexes (and NGE's) for EOL-type policies, it should be assumed that the dividends credited on or before the "cross-over" point are applied under the dividend option which produces the level death benefit, and thereafter applied to reduced premiums. Therefore, the cost indexes are not reduced by dividends due on or before the "cross-over" point, but cash values and death benefits purchased by these dividends are implicitly taken into account in the cost index calculations.

We recommend basing cost indexes fot EOL-type policies on the assumption that dividends are used to reduce premiums after the "cross-over" point because:

1) this approach produces a level death benefit for the life of the policy – the basis on which the policy is usually bought

2) this approach will reduce the temptation of insurers to market EOL-type policies featuring negligible reductions in the initial death benefit, solely to take advantage of the more favorable cost indexes produced based on use of the special dividend option

With respect to the form of EOL policy using deferred paid-up additions, the "cross-over" point typically will be the policy anniversary on which the initial death benefit decreases. At that time, the deferred paid-up additions illustrated invariably will be greater than the amount needed to maintain a level death benefit. For these cases, if the cross-over point is less than 20 years from issue, the death benefit used in determining the cost indexes will not be level.

Revertible Term Policies

These policies have two premium levels. The insured is charged premiums at the lower level only if he submits satisfactory evidence of insurability at specified intervals.

For these policies, we recommend that cost indexes be disclosed as follows:

1) Cost indexes based on the assumption that the insured always qualifies for the lowest possible premium level

2. Cost indexes based on the assumption that, for all periods after the initial period, premiums are charged at the higher level

On each basis, disclosure of the NGE would be required if any element was not guaranteed. Also, a clear explanation would be required with respect to the conditions that must be fulfilled for an insured to qualify at specified intervals for lower subsequent premiums.

We recommend adoption of this disclosure approach for revertible term policies for the following two reasons:

1) The cost is not completely under the insurer's control

2) The cost can be affected by changes in the insured's health or the insurer's underwriting standards

Adjustable Cash Value Policies

These include policies under which the cash value is credited with interest at a guaranteed rate (e.g., 3.5% or 4%), plus excess interest and whose pricing reflects term rates which can be increased up to a guaranteed maximum. If these policies turn out to qualify in tax treatment as permanent life insurance -- rather than as a term plus annuity combination -- the regular life insurance cost disclosure rules should apply. This would include NGE's based on the difference between (1) cost indexes based on the guaranteed minimum interest rate and maximum term rates; and (2) cost indexes based on currently illustrated interest rates and term rates.

Also in this category are policies with face amounts and cash values geared to a high "new money" interest rate but which are not guaranteed beyond a relatively short period. For these policies, NGE's should reflect the difference between 1) cost indexes based on continuation of the initial interest rate; and 2) cost indexes based on the maximum reduction in face amount and/or cash value which might occur after the initial guaranteed period.

Multi-Track Policies

These are policies such as adjustable life or deposit term which allow the insured the option to increase or decrease the amount of insurance and/or to change or convert the plan of insurance.

For these policies, we recommend that disclosure of cost indexes be based on the assumption that the automatic option is exercised. We also recommend that an additional display of cost indexes be permitted, based on stated assumptions as to the exercise of the options.

"Term Plus Annuity" Combinations

For these cases, the two coverages may be provided by separate contracts or by a base policy together with a rider. Dropping or changing one coverage may or may not affect the other. Here, relative to cost disclosure, we recommend that the Life Insurance Solicitation Regulation be applied to the term part of the package, and the Annuity and Deposit Fund Disclosure Regulation to the other part.

It should be noted that an ACLI task force is considering the broader question of appropriate general disclosure with respect to "correlated sales" (i.e., sales of term insurance in conjunction with annuities or other savings funds). Such general disclosure requirements would be coordinated through appropriate language changes in the Life Insurance Solicitation Regulation, the Annuity and Deposit Fund Disclosure Regulation, and the Life Insurance Replacement Regulations.

Respecrfully submitted,

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