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ATTACHMENT FOUR

STATEMENT ON BEHALF OF THE
AMERICAN COUNCIL OF LIFE INSURANCE
TO THE
NAIC (A) COMMITTEE'S MANIPULATION,
LAPSATION, DIVIDEND PRACTICES AND
ANNUITY DISCLOSURE TASK FORCE

June 8, 1982

My name is Anthony T. Spano, actuary with the American Council of Life Insurance. This statement is presented on behalf of the council, whose 529 member companies account for about 96 percent of the life insurance in force in the United States.

We appreciate this opportunity to comment on the lapse disclosure system proposed by your Advisory Committee on Policy Lapsation. Our statement today incorporates many of the remarks we presented at your task force meeting on June 2, 1979 and which we have reiterated at subsequent meetings, but also contains some new observations that have a significant bearing on this subject.

Comments on Proposed Lapse Disclosure System

As we have indicated, we are in basic agreement with much of the advisory committee's first report, presented in December, 1978, and feel that it furnishes an excellent analysis of the subject. In particular, we think that the information in Chapter VI of the report concerning techniques for improving policy persistency can be very useful to companies experiencing lapse problems. On the other hand, we must emphasize our serious and increased concerns with the proposed disclosure system described in the advisory committee's reports of December, 1979 and June, 1981. The following are some of our continued misgivings:

1. Serious questions about the potential value of the required data to the regulators, especially since we are not aware of any information concerning the extent to which regulators feel the proposed system would be useful.

2. Susceptibility of the data to abuse and misuse on account of the information being available for public use without appropriate interpretation.

3. Failure of the proposed system to recognize many characteristics that are highly influential in determining lapse rate levels.

4. Concern that adoption of the proposed system might induce companies to abandon or not enter some legitimate and socially desirable markets, in order to avoid the risk of high lapse experience.

5. Questions as to the credibility of the data that would be produced, especially in rhe case of smaller companies.

6. Concern about the cost of producing the required data, especially for smaller companies.

In addition to these concerns thar we have been expressing since this disclosure system was first recommended, we feel that recent changes in the insurance markerplace have served to magnify the shortcomings of the proposed system. The introduction of a wide variety of new life insurance products and the increase in policy replacement activity clearly have reduced further the extent to which the system could be at all effective in interpreting and improving persisrency experience. As examples of the additional problems resulting from these recent events, we cite the following:

1. The producr commonly referred to as "universal life insurance" has aroused considerable attention and is being marketed to an increasing extent. Under a universal life insurance policy, the insured has considerable flexibility with respect to the amount and timing of premium payments. It is possible for the insured to skip premium payments and still have the policy continue in force, even until the point at which the policy expires or matures. Under these circumstances, when is a policy to be considered as having lapsed for the purpose of the proposed disclosure system? How about the situation where a premium is paid, but at a substantially lower level than the policyholder had been paying? Should this be considered a partial lapse and, if so, how should the amount lapsed be measured?

2. Another recent product is "adjustable life insurance." The policyholder must pay premiums on the specified due dates but can request changes in the amount of the premium, the amount of insurance, or the plan of insurance. The policy thus can be changed from a permanent insurance plan to a term plan, and vice versa. How are such policies to be handled under the advisory committee's proposed system, which calls for a separation of the experience between permanent and term insurance?

3. Nonparticipating insurance is now being written on an adjustable-premium or "indeterminate-premium" basis, under which the company can change the premium rate after issue subject to a maximum premium rate guaranteed in the policy. Lapse experience under these policies would be expecred to be different from the experience under corresponding policies issued on the traditional "guaranteed-cost" basis, which do not provide for premium rate changes after issue. Under the advisory committee's proposal, experience under these two different types of plans would be grouped into one reporting category, thus further reducing the possibility of any meaningful interpreration of the results.

4. Another recent marketplace phenomenon has been a sharp increase in replacement activity, with indications that perhaps half of all lapses involve replacement situations. The revised NAIC Life Insurance Replacement Model Regulation adopted in 1978 is based on a recognition that a replacement is not necessarily disadvantageous to a policyholder, i.e., some replacements are well-justified and definitely in the consumer's interest. One can see the

obvious conflict between a company trying to maintain good persistency, which would mean combating all replacement activity, and trying to promote the policyholder's best interest, which sometimes would mean not resisting a replacement. The higher the volume of replacements, the more serious would be the company's dilemma.

With all these disadvantages and problems, we feel it is not possible, especially in today's economic times, to justify a requirement that companies comply with the proposed lapse disclosure system. Using the advisory committee's estimate that the average cost per company of developing the proposed system is $20,000, it is clear that the cost for the industry would run well into the multimillion dollar range. Certainly, it is to a company's best interest to improve policy persistency, and the advisory committee's original report points out that companies use many means to improve their lapse experience. In lieu of the advisory committee's proposal, which would add needlessly to company expense without producing meaningful and useful results, we would urge an alternate approach that would make use of mechanisms and procedures that many companies already have in place and that would be effective in helping to analyze and improve lapse experience.

Recommended Alternate Approach

The following are the features of the council's recommended alternative to the advisory committee's proposal:

1. Lapse performance would be reviewed as part of the periodic examination of companies by insurance departments. This would enable regulators to make meaningful analyses of both the level of the company's lapse experience and the effectiveness of its efforts to control this experience. They also will be able to determine whether company sales practices are causing excessive lapses.

2. Regulators would conduct special reviews between examination intervals to handle critical problems that might arise for a particular company and that require immediate attention.

3. Companies would be asked to develop lapse rates and make them available for examination by the regulators. It is recommended that lapse rates be required only for the first policy year. The greatest losses to policholders and companies arise from first-year lapses, and such lapses are more amenable to company control than those occurring in later policy years. Given these factors and especially considering the volume of recent replacement activity, the development of lapse rates for policy years after the first would add to the efforts required of the companies without producing comparably valuable information for the regulators.

4. With the level of lapse experience influenced by numerous characteristics, the calculation of actual-to-expecred ratios as suggested by the advisory committee would carry with it the strong possibility of producing distorted conclusions about the quality of a company's performance. For this reason, we recommend that companies not be asked to calculate actual-to-expected ratios. Instead, we propose that a table be developed showing appropriate first-year lapse rate ranges for the major characteristics that affect policy persistency. This table would be in a form that can be used by regulators in interpreting a company's experience. In this connection, the general trend of a company's experience should be an important element of this interpretation.

5. The advisory committee's proposal calls for a subdivision of lapse results into four categories of business: debit ordinary, pension trust, permanent ordinary, and term ordinary. While these classifications seem reasonable, companies should be free to develop data for different or additional classifications that might facilitate a more meaningful analysis of their experience, particularly where companies already have in place an effective lapse analysis system. The recent introduction of many varieties of nontraditional products gives additional importance to this consideration.

6. Companies and regulators should be encouraged to study and make use of the material presented in Chapter VI of the advisory committee's first report. This chapter contains an excellent description of techniques that can be effective in improving persistency experience.

This alternate approach would enable that full collective effort between the company and the regulator that is so important in achieving common goals. By providing meaningful and timely information, this recommended approach should be effective in helping to achieve a general improvement of lapse experience to the benefit of the industry, the regulator, and the consumer.

We thank you for your attention and will be glad to answer any questions you may have.