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ORDINARY—NEW PRODUCTS

A discussion of new individual product developments designed to meet conditions in today's market.

CHAIRMAN CHANDLER L. McKELVEY: Our world has changed. The process of product innovation in our industry has been one of reaction. There is no certainty that we have reacted quickly or aggressively enough.

MR. WILFRED A. KRAEGEL: I would like to list: the more important of today's market conditions, the characteristics of ideal products for meeting those market conditions, and some of the obstacles which make it quite difficult to do so.

Market Conditions

Thinking first about the market conditions themselves, let's break them down into those which occur in the life of the individual consumer and those which deal with the economic environment in which the consumer must operate. Those dealing with the individual consumer include the following:

1. Education level -- This has increased steadily in the past decade or two resulting in a population which is much more knowledgeable about many things. Most adults below age 65 are high school graduates, and roughly 15% are college graduates. However, the knowledge does not always extend to the economic level.
2. Income progression -- Income levels have increased dramatically in the past decade or two. Families which include an adult male had a median income of about $6,000 in 1960, and it is approaching $14,000 today. The increased income is partly due to inflation but also in large part due to working wives and productivity gains which have increased levels of affluence for the population as a whole. People have much to lose - and hence much more to insure. Another significant facet of income progression is the pattern of income for an individual during the life cycle. Even if we remove the effects of inflation, the individual's income level varies considerably from the younger ages to the older ages.
3. Mobility -- We are a mobile people both in our jobs and where we live. In the short time between 1970 and 1973, 32% changed their place of residence. This mobility influences our needs to some degree.
4. Number of children -- The number of children per family is declining significantly. Twenty years ago young women expected to have 3.2 children on the average, while today it is down to 2.1. However the expectations of money required for bringing up each child have increased substantially. They tend to offset each other but this is still a major consideration in the changing needs of the individual. Parenthetically, adults today tend to have fewer dependents for another reason - the less frequent support of retired people by their relatives.

5. Two income families -- The 1970 census showed that about ½ the wives in husband-wife families also received income. This is another emerging phenomenon with dual effects on the life insurance business. On the one hand, the working spouse takes away some of the urgency for providing coverage to meet the needs of the family if the primary breadwinner dies or is disabled. On the other hand, however, the two income family becomes accustomed to a much higher standard of living and would find it very difficult to curtail that standard rapidly in the event of loss of one of those incomes. Again we see the opportunity for more frequent changes.
6. Working women -- The number and proportion of women in the work force is increasing, as well as the varieties of jobs they hold and the level of responsibility they achieve. Besides the reflection of this in two-income families, this is a phenomenon which affects marketing directly as we try to serve these women.
7. Frequent divorce -- This possible event in the life cycle is another reason for sudden changes in individual circumstances.
8. Complexity of lives -- The consumer's life is filled with many activities calling for his or her attention and consequently he seeks to handle as many of them as possible in simple and routine ways.

In addition to the market conditions arising out of happenings in the lives of individuals, there are a number of others which relate to the entire economic environment:

1. Inflation -- This is a topic of great relevance, magnitude and urgency which we will not discuss in this panel except as it relates to coverage requirements for the individual. It is obvious that inflation changes both the needs for coverage and the ability to pay.
2. Employer-supported benefits -- For those companies which do a substantial business with employers through group and other forms of insurance this is a significant development on the plus side. However, it has the reverse effect on companies which primarily provide individual insurance needs.
3. Government-supported benefits -- Social Security has continued its relentless trend upward, both in the coverage provided and in the proportion of salary taken. In 1954 the employer and employee each paid 2% of the first $3,600; this year it's 5.85% of the first $14,100. Initially these benefits were thought to provide only a floor of protection and thereby might stimulate the desire for additional amounts of protection on the part of the majority of people. That probably was the case in the past but it is becoming less so in the present and future. Social security formulas now provide a substantial part of income lost at death or retirement for the lower income categories. This means that more companies will increasingly concentrate on middle and higher income consumers. At the same time, the ability to pay for life insurance has been reduced by the higher costs of Social Security.
4. Consumerism -- This relatively recent force has already had much effect on a variety of products and is currently exerting an influence on life insurance products. Although the force for change is obvious the actual effects are not yet clear. Emphasis so far has centered on cost and value comparisons with some controversy on other issues, such as the "captive field force".

5. Tax burdens -- As the spending of governments at the various levels has increased, tax burdens have become more and more significant both at the individual and at the corporate level. At the individual level this has tended to increase the coverage required while at the same time decreasing the ability to pay. At the corporate level, the higher taxes have diminished the ability of life insurance companies to offer good value for the premium dollar.
6. Computer processing capabilities -- Most life insurance contracts for the individual are not very much changed from those which were developed decades ago. Generally these contracts have served their purpose exceedingly well. However, they were designed in the context of limited data processing capabilities and so they appear relatively rigid in light of today's processing capabilities. The computer has opened up the opportunity for more responsive products if other conditions permit.
7. A host of other changes have taken place, and are now taking place, which influence our market. These include changes in the proportions of the population at different ages, the variety of life styles, the great numbers of products and services competing for the consumer's dollar, the enlarged services of competing financial institutions, the fears about unlimited economic growth, and finally the values and attitudes which emerge out of all these other developments. Of particular importance are attitudes about personal responsibility for oneself and for others. One of these which should give us concern is the increasing tendency to look to government and the employer for security instead of to one's own resources. This was brought out in the MAP (Monitoring Attitudes of the Public) program of the Institute of Life Insurance. When asked "Who should take care of all life insurance needs?", the number of those who answered "the individual" decreased from 73% in 1968 to 56% in 1974; those who answered "the employer" increased from 18% to 30%, and those who answered "government" increased from 6% to 12%. Does that say something to product design, or was that change inevitable?

Characteristics of Ideal Products for Today

Let's consider first the kinds of needs which the consumer has for personal financial security as shown in Chart A. These needs can be broken down into two kinds of protection - protection against loss of income or estate and protection against loss of assets. The protection against loss of assets tends to be the province of the casualty companies, as in the case of property loss and liability suit. Many life insurance companies, however, do offer protection against sickness and accidents by providing funds for paying those bills. Life insurance companies concentrate on protection against loss of income or estate, specifically for premature death, disability, and survival to retirement. The fourth contingency, involuntary unemployment, is included here only to complete the picture. Note that the "who" column on the left hand side indicates who pays directly for the protection - the individual, the employer, or government. In this concurrent session we will limit our attention to the contingencies of premature death and survival to retirement.

<u>Chart A</u>

Consumer's needs for
personal financial security:

Who Pays	Protection against loss of income or estate	Who Pays	Protection against loss of assets
IEG	in case of premature death: lump sum to meet obligations income for dependents and/or business	IE	in case of sickness or accident: payment of bills
	estate for heirs (taxes)	I	in case of property loss: reimbursement for loss
IEG	in case of disability: income for consumer, dependents and/or business	I	in case of liability suit: legal protection payment of claim, if suit is lost
IEG	in case of survival to retirement: income for consumer and dependents estate for heirs (taxes)		
EG	in case of involuntary unemployment: income for consumer and dependents		

I = Individual
E = Employer
G = Government (taxpayers)

I am sure that there are different views about what constitutes an "ideal product", but for purpose of discussion let me offer the following list. The ideal product:

1. <u>Provides adequate coverage to meet current reasonable financial objectives</u> -- This criterion is probably met much more frequently today that it was in the past. The declining premium per thousand, coupled with the increasing premium per policy, indicates that the consumer is much more concerned about having adequate protection from the early stages of the program. However, I would like to emphasize that reasonable financial objectives should include provision for retirement and estate needs as well as for the death contingency.
2. <u>Adapts to meet changing needs for coverage</u> -- As an individual experiences those changes in his or her life cycle that I listed a minute ago, the needs for coverage change accordingly, generally in an upward trend. Ideally the contract should be responsive to those changes as they occur.

3. Adapts to meet changing ability to pay for coverage -- This is the other side of the coin. Usually as the needs for coverage change, the same conditions simultaneously change the ability to pay -- an increase in salary for example. As the ability to pay increases, a proportionately higher part of it should be applied to provide for the ultimate requirements of survival to retirement.
4. Takes little consumer effort to understand, acquire, and maintain -- This point harks back to the complexity of the life of the typical consumer. Protection against loss of income or estate is extremely important whenever such a contingency occurs but it should be handled simply and routinely under normal circumstances.
5. Makes best use of agent/financial counselor time -- There are great variations in productivity of agents, perhaps accounting for some of the difficulty which we have as an industry in retaining them. The ideal is to construct a framework in which both the agent/counselor and the consumer recognize the service as timely, useful, and well worth the cost.
6. Is easy to service in Field and Home Office -- Ease of processing reduces delay, decreases errors, and facilitates a smoothly running operation. These are important to any ideal product.
7. Offers good value compared to alternatives -- Generally speaking, to the extent that we are successful in meeting the other qualities of the ideal product, we are likely to meet this quality as well. The word "alternative" used here means not only a variety of insurance products from a variety of insurance companies, but also banks, savings and loans and other institutions which provide some portions of the services which we provide.

Major Obstacles to the Ideal

Whenever we talk about major problems it is helpful to consider them in groups of four--harking back to the Four Horsemen of the Apocalypse called Conquest, Slaughter, Famine, and Death. The Four Horsemen I am about to name are not nearly so disastrous but can nevertheless cause a good deal of trouble. They are tradition, taxation, regulation, and distribution.

First, tradition. We are a mature industry with good products and a good distribution system and it is not easy to change. Our products are generally unique to our industry and our customers have a reasonable familiarity with the services which we provide. Besides that, we as managers are comfortable with what we're doing. Tradition is not a serious obstacle to change when a really significant reason for change comes along. However, tradition does tend to discourage a search for that better way of doing things, and tradition usually wins in the case of a tie.

Second, taxation. Life insurance companies pay very large federal income taxes. However, no part of the reserve increase from year to year is taxed directly as income to the policyowner. If we try to offer more flexible products and change the nature of the reserves held, then we run a risk of having additional taxes on the reserve build-up added to the extremely high taxes we already pay. This could be grossly unfair in competition with other savings institutions.

Third, regulation. The life insurance laws and regulations of the various states were set up to control the kinds of contracts currently in existence. The flexibilities which might be needed to provide the ideal product described above do not always fit comfortably into the present legal structure and, in fact, may conflict sharply. Special committees of the Society of Actuaries and of the National Association of Insurance Commissioners have been looking into the possible revision of standard valuation and nonforfeiture laws and that is one vital element in considering this question. For example, many states have a regulation which limits backdating. Some methods of providing flexibility in a life insurance contract could easily be construed as backdating. There was no doubt good reason for this regulation in the past, and there may be good reason for continuing some version of it in the future. However, this might be something to change if we wish to encourage flexibility for meeting the consumer's changing needs.

Fourth, distribution. Of the four obstacles, this may be the most difficult one to meet. The present distribution system for insurance to individuals grew up primarily because of the reluctance of the consumer to make this kind of purchase on his own without proper guidance and motivation. Although the difficulties and disadvantages of the present distribution system are widely recognized, it may still be the best one available. At this stage we don't know for sure one way or the other. Generally speaking, we want to improve the productivity of the agent and we want to provide a meaningful and economic service to the consumer. This could mean a greater emphasis on serving and keeping existing customers with less effort needed to hunt for new ones. However, going in that direction might require a new kind of agent/financial counselor, and such a basic change could not be undertaken without great care, both for the rights of consumers and for the rights of existing agents.

Some Recent Innovations

If this panel had not begun with these introductory comments, you probably would not even have missed them. However, we think it is time that our industry paid more attention to these things. One of the many chicken/egg questions in life is whether a new product creates the market or the market calls for a new product. The answer is "some of each", of course, but I would lean toward the market conditions shaping the product as the stronger of the two forces. So, as we talk about some recent innovations and as we consider what should come next, let's bear in mind these thoughts about market conditions, characteristics of ideal products, and the obstacles we face in reaching such products.

MR. DAVID M. MORDORSKI: Mr. Kraegel's list of ideal product characteristics seems very reasonable, yet I have to confess that when developing new products I have never referred to such a list. Rather, I have just tried to answer the question "Will it sell." It seems a truism that any product, which when thoroughly and openly presented to today's consumers achieves public acceptance as measured through sales, while generating a reasonable expected profit or contingency margin, is properly designed to meet the conditions in today's market. I view the ideal product parameters suggested by Mr. Kraegel as a vehicle for predicting whether a new product will be a success in today's market place. As such, they are extremely valuable.

At this stage I would like to discuss a few of the new ideas I see in the market today relative to these ideal product characteristics. When trying to prepare a list of new products, I was surprised to see how few truly new products there are. Virtually all of the "new" policies we see are adaptations to some extent of our traditional products. This is probably due to the four obstacles referred to earlier: tradition, taxation, regulation, and distribution. It is simply very difficult in our current regulatory environment to come out with a revolutionary new product; witness the problems of variable life insurance.

New products I have seen lately include those for the IRC Sec.79 market which seem to fall into three general categories:

1. Separately marketable decreasing term and increasing permanent policies designed so that the two when combined give the appearance of an ordinary life plan.

2. Level annual renewable term with a pure endowment rider which again looks like permanent insurance.

3. A conventional permanent policy with an endorsement splitting the face amount and premiums for Section 79 purposes.

Other relatively new products include versions of deposit or collateral term and various guaranteed issue policies. The latter usually contain fairly strict amount limits and provide that, except in the case of accidental death, a limited death benefit is provided in the first few policy years. Term plans, though hardly new themselves, have given rise to a number of coverage innovations such as the ability to restore the initial face amount on decreasing term at either programmed intervals or certain life events. There is also a family of increasingly popular products which consist of some type of flexible deposit arrangement, usually with an annuity purchase guarantee. These contracts allow a policyholder to put in varying amounts of money, guarantee the principle along with some rather low level of interest and pay excess interest as declared annually by the company. They appear to be gaining considerable momentum since the creation of the IRA market.

While there are undoubtedly many other new products being marketed today, I am going to confine my remarks at this point to the last two categories I just mentioned, that is, term plan innovations and flexible premium annuity contracts. I hope that you will bring up some of the other product ideas for discussion following the formal presentation.

The term market seems to be getting more competitive in both benefits and price almost weekly. In terms of benefits, the key appears to be flexibility. A policyholder is allowed to start his decreasing term period over again without evidence of insurability at the end of a certain interval or at the birth of a child or perhaps even at the purchase of a new home. This all amounts to a type of guaranteed insurability which allows the policyholder to make up his mind subsequent to purchase as his coverage needs change. In somewhat the same vein, level term insurance can have periodic options for the policyholder to increase his coverage by paying an attained age term rate on the increased portion. Another attractive feature is the use of a conversion allowance to induce the election of permanent coverage at a time when the policyholder is more able to afford it.

These benefits seem to be a step in the right direction in terms of providing adequate coverage, allowing flexibility for the policyholder to meet his changing needs and ability to pay, making good use of the agent's time, and offering good value. With careful planning they can also be made relatively easy to understand and service. Since in many instances these innovations do not cause major problems in the areas of tradition, taxation, regulation, and distribution, it's easy to see why they have become so popular. I think we can project that, as long as they can continue to be accurately priced, they will continue to grow in popularity.

The other product I would like to discuss is actually a family of products generally taking the form of a flexible premium annuity, sometimes packaged with life insurance. It is easy to understand why these products have caught the attention of a lot of people. The IRA market has tremendous potential; the product's flexibility, competitiveness, and simplicity mean that it satisfies most of the parameters Mr. Kraegel spelled out earlier; virtually every day while driving into work I hear a major brokerage firm advertising a version of these as an investment currently yielding 8%, with interest tax-deferred, and providing full liquidity. Given all this market appeal I have to ask myself why I feel so uneasy about rushing into this type of product.

I guess most of the answer lies in the obstacles outlined earlier. To a significant extent, these contracts allow the separation of the term and savings element of our traditional permanent insurance plans. In doing this, we destroy the frequently used argument of a forced saving plan. Secondly, there is the significant obstacle of taxation. Can a company selling this type of policy take an interest paid deduction on its tax return for the interest credited to these contracts? Does the policyholder have to declare as taxable income the interest credited on this contract each year, or alternatively, under what circumstances will the interest earned be deferred income? While I am far from a tax expert I know that I have heard responsible opinions expressed on both sides of each of these questions. I would certainly hate to be the actuary who competitively priced one of these contracts, assuming that it qualified for an interest paid deduction, only to find out 5 years later in an adverse court ruling that it doesn't. In the area of regulation, there are several potential problems. The NAIC C-3 Sub-Committee has expressed a concern about the equity of such contracts. The SEC recently held that one such contract with an annuity guarantee is a security and as such is subject to Federal Securities Laws.

Probably my greatest concern, however, with some of these contracts has to do with the very nature of the contracts themselves. They offer high interest rates on long-term contracts with full liquidity guaranteed. I suspect that many of these contracts are being backed with assets that have long-term maturity dates. If we picture for a minute a period of generally declining interest rates for several years followed by a period of inflation and rapidly increasing interest rates, it's easy to see what could happen to a company which experienced significant terminations at that time by policyholders moving their money to more favorable investments.

Without dwelling much longer on this product then, it seems it has tremendous sales potential and that we, as actuaries, have the job of making sure it is designed in such a manner that it is a long-term financial success for the companies issuing it.

MR. ROBERT E. HUNSTAD: Before describing a Minnesota Mutual product innovation which, I believe, satisfies many of the criteria that Mr. Kraegel has set forth, I thought it would be valuable to you to cover some additional background. Prior industry discussions of new products have focused on the phrase "life cycle policy".

Definition

"Life cycle policy" was first used in the publication "With An Eye To Tomorrow", a report on the Future Outlook Study published by the Institute of Life Insurance in 1967. On page 63 of that report, a capsule summary of their discussion reads as follows:

> "The suggested life cycle policy, designed to permit the increase in protection or cash value at any time, can take the place of a multiplicity of fixed contract forms. It will permit more precise programming, while greatly reducing the policy portfolio, and should lead to more consistent after-sales service."

In this capsule summary and elsewhere in the text, the study group defined the value of life cycle policy as being:

1. Increase or decrease to meet insurance needs.
   a. Face amount.
   b. Cash accumulation.
2. Coordinate payment of premiums with changing cash flow.
3. Produce economies to the insured - one policy fee (or band equivalent).
4. Improve service.

The changes in needs that occur throughout an individual's lifetime can be illustrated graphically. Let's first look at the life insurance needs and how they change over a lifetime (See Exhibit 1).

The basic need present in most situations is the type of insurance coverage that I have termed "burial cost". Other parts to the total needs picture that are unique to each individual include survivor income benefits, and estate settlement needs. Some individuals also have needs for temporary business insurance.

In developing a chart such as this, recognize that each individual may have different needs at different points in time. The preceding was somewhat generalized. Exhibit 2 is a more specific example based on one of the individuals described in Jack Bragg's paper on the future of the actuarial profession presented at the 1974 annual meeting.

Equally important is the ability to pay and how that changes over a lifetime. There are two primary elements (See Exhibit 3). The first is the income of the individual. The second is the spending needs. These lines may change dramatically from year to year, and the difference between the two lines may be either positive or negative. Not only does this give us a picture of the ability to pay for life insurance but also indicates the need for accumulation of cash savings - particularly as we incorporate the retirement income needs of an individual into his life cycle.

History

Although the concept of a "life cycle policy" is relatively new, we should recognize that there have been previous attempts to meet changing needs of an individual over his lifetime -- both needs in terms on life insurance protection and needs in terms of ability to pay. Perhaps the first of the insurance-needs related policies is the "jumping juvenile". This policy acknowledges that life insurance needs prior to maturity are nominal and there is, in many situations, a marked increase in those needs at some point in an

Exhibit 1

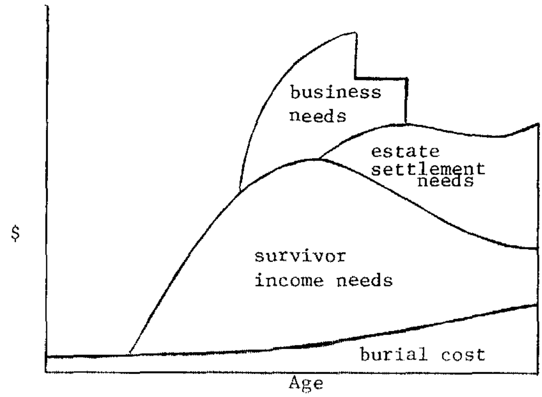


Exhibit 2

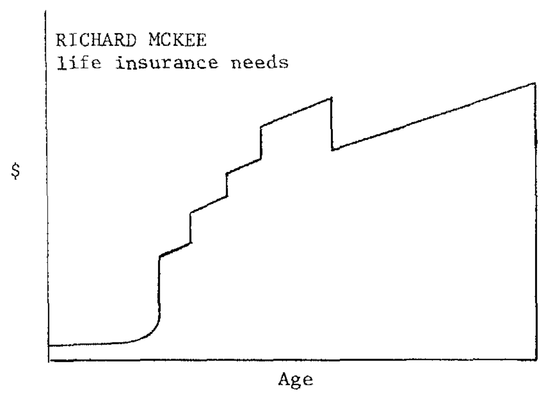
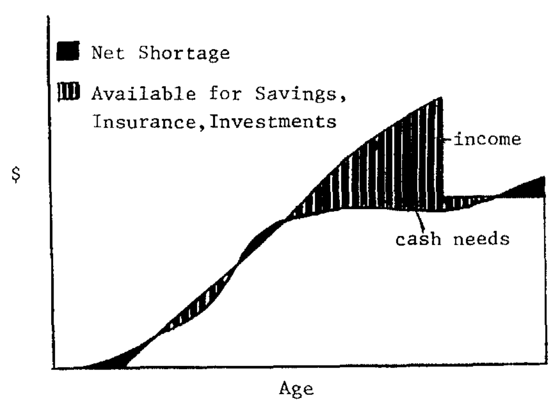


Exhibit 3



individual's lifetime. This could be viewed as a crude approximation of matching an individual's life cycle.

There have also been policies developed to meet the ability to pay -- primarily modified premium policies or preliminary term policies.

More recent developments provide even greater flexibility in meeting needs. Foremost among these is the guaranteed purchase option allowing the choice of additional insurance to be purchased (or not purchased) at specific option dates or at the occurrence of specific events. Because this provision allows some selectivity on the part of the individual, it provides a better adaptation to changing life cycle needs. However, it may not always be adequate.

Cost-of-Living Riders also provide future change capabilities as the cost of living increases. This reminds us of one of the principal reasons for change in needs throughout the lifetime -- inflation. Unfortunately some of these provisions have inside limits on the aggregate percentage increase since time of issue.

Adjustable Life

The Adjustable Life policy offered by Minnesota Mutual was first test-marketed in 1971. To my knowledge, this policy comes closest to meeting the definition of a true "life cycle policy". Although there are other unique features of this policy which I will describe later, the key reason for making this statement is that the policy allows for changes in face amount and/or changes in premium -- both up or down -- within the same policy contract. Thus, it is possible to vary the amount of insurance as needs change, vary the amount of premium as ability to pay changes, and, depending upon the level of premium payment, also vary the cash accumulated in the policy.

Let me state first that increases in face amount, with two exceptions, are subject to evidence of insurability. However, no evidence is required for any other change (decrease in face amount or change in premium).

Even though the original discussion of "life cycle policies" by the Future Outlook Study concedes evidence of insurability would be required on increases, we feel the ideal "life cycle policy" should minimize, if not eliminate, such requirements. We do have available two provisions which eliminate evidence requirements. The most recognizable of these is an option comparable to the guaranteed purchase option. This is an extra cost rider available at time of issue.

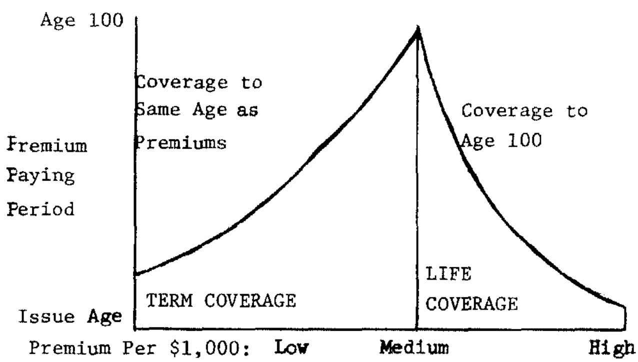
The other provision is included in most policies on an automatic basis. This provides an increase based on the cost of living -- such increase to be made each three years, provided there has been no intervening change in the face amount. The amount of each increase is based on the ratio of the respective Consumer Price Indexes. The maximum contractual increase is 20% of the face amount then in force or $20,000, whichever is lower. This provision is in effect until the policy anniversary nearest age 55. Unlike cost-of-living riders commonly offered, there is no aggregate limit to this benefit. In fact, this benefit combined with guaranteed purchase options could result in ultimate insurance in force 56 times the original underwritten amount. (This ratio is accomplished because we allow juveniles to purchase guaranteed purchase riders equal to five times the underwritten amount.) All of this can be accomplished with one policy document and one policy fee.

The change procedure for Adjustable Life takes into account the cash value as of the date of change. Cash value is never released because of the change, and thus no evidence is required. A new contract is never issued. A new premium and cash value page is incorporated into the original policy. This provides great potential savings in elimination of multiple policy fees.

Reserves are calculated on the Commissioner's Reserve Valuation Method. Cash values are reserves to the nearest dollar. Each subsequent change after time of issue results in a recalculation of the expense allowance. In effect, additional expense allowances will be taken as the policy is changed in face amount or in premium per thousand. This will all be subject to maximum expense allowances under the Standard Valuation Law and also meet the requirements of the Standard Nonforfeiture Law.

One of the basic unique features of this policy is the calculation of the plan of insurance. Essentially, there is an infinite range of plans available to the client from short period term insurance to limited pay life (See Exhibit 4). The premium and face amount determine the plan of insurance. Each change in the premium per thousand produces a change in the plan of insurance. For premiums in between two discreet plans of insurance (say, 15 year term and 16 year term), the extra premium contributes to the cash value at the expiration of the shorter of the two term periods. A similar method is used for paid-up life values with the paid-up value produced for the longer of the two limited pay life policies slightly in excess of the face amount.

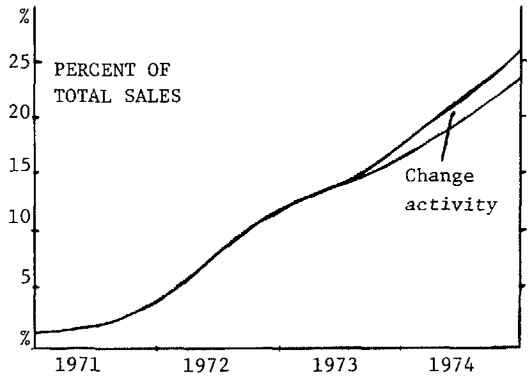
Exhibit 4



Sales and Financial Results

Since original test marketing in 1971, Adjustable Life has grown to 25% of the policies issued representing 15% of the face amount issued and 12% of the new annualized premium. In 1974, total sales were in excess of $70,000,000. Changes to existing Adjustable Life policies now are beginning to make an important contribution to our total sales figures (See Exhibit 5). It's our feeling that the change activity on in-force policies is the area in which the product will succeed or fail. Although only preliminary results are available to date, the direction is distinctly positive.

Exhibit 5



Because of the method used in deriving the plan of insurance and the subsequent administrative activity required, the marketing and administration of Adjustable Life depends heavily on our computer resources. The current dividend formula takes into account total past history of an individual policy. A traditional three-factor approach is used with modifications to reflect the various changes which may have occurred on an individual policy.

When we undertook the marketing experiment, we did so without first attempting to establish a total administrative and sales system. Thus, we are still in process of developing complete procedures and computer programs for the total administration of this product.

It's premature to judge the financial results achieved thus far. Certainly expenses are still at a high level because we are still in the developmental stage for our administrative system. Lapses on Adjustable Life appear comparable to our normal persistency experience. A bright spot is in the policy loan area where the ratio of loans to available cash is low compared with the balance of our portfolio. We have no credible experience on our mortality results as compared with other policies.

Although the product is not yet available in all states, we feel we have been fairly successful in securing state approvals. At this time, six jurisdictions have not yet approved the product.

<u>What Next?</u>

Our thoughts in terms of products of the future rely more heavily on adaptations and modifications of our Adjustable Life policy than directing our efforts to distinctly new products. We see important improvements that can be made to provide a better product for the consumer:

1. Develop a "cash withdrawal" basis in lieu of policy loans. The principal problem to overcome is the repayment of the cash withdrawn and the avoidance of any selective manipulations.

2. Possible alternatives to traditional reinstatement. This may be accomplished through the use of extended term nonforfeiture options and "stop-and-go" premium provisions.

3. New dividend options come to mind with this product - specifically one which simply is "paid in" to the cash value of the policy. The principal deterent here is the requirement (under our current system) that new policy value pages be prepared for each change.

4. We would like to continue to explore other underwriting modifications. For example, waiving evidence of insurability for certain increases coincident with increases in income, estate accumulation, loss of group coverage, etc. There are still major antiselection problems to overcome in this area.

5. Adaptation of the plan to provide endowment benefits.

6. Adaptation of the plan to fund individual policy pension trust business. This adaptation is currently under way with a target of January, 1977, for its introduction.

Other Industry Activity

As part of my preparation for this meeting and because of activities in certain other companies of which I was aware, I constructed a questionnaire earlier this year. This questionnaire was sent to 86 of the largest life insurance companies (based on ordinary insurance in force). I received 74 replies.

In general, the replies indicated that there are few specific plans although there is some interest in the development of a life cycle policy. Primary problems associated with the development are the tooling-up costs and the difficulty in securing state insurance department approvals. (Many of these concerns are centered on the Standard Nonforfeiture Law and the Standard Valuation Law.)

The major reasons why a life cycle product might not be successful are identified as the difficulty in explaining it to the consumer and the difficulty of providing service to the client.

It's clear from the results that not all of the respondents used the same definition of "life cycle policy".

CHAIRMAN McKELVEY: We have examined some of the actions being taken by the insurance industry today, to meet today's market. What's next?

MR. KRAEGEL: "What's next?" is a question with many possible answers. What actually happens will be the sum of what we in the industry try to make happen, plus what others consciously try to make happen (e.g. government, consumerists), plus outside conditions and events, plus what consumers ultimately decide. There is no one best way to go -- and even if there were, we wouldn't know what it was. But we do have some guidelines which are likely to move us in the right direction:

1. Focus on what's best for the consumer. That's not always easy to determine, but consciously thinking about it will tend to make it happen more often than not. Nor is it always easy to do, when it seems to be harmful to the company or its agents; the consumer-oriented action may be painful in the short run, but will likely avoid an even greater pain in the long run.

2. Think through the future consequences of current decisions. We're not very good at this yet, but we can learn.
3. Select objectives to be met in the future, and make current decisions which are most likely to meet them.
4. Try to bring out all the alternatives, so that the best decision is not overlooked. This can stagger the mind, but within reason one (or a team) should be familiar with the regulatory and tax implications, as well as the potential use of innovation in design, distribution and processing capabilities.
5. Work on eliminating the obstacles to the "better product". This might involve regulatory improvements, tax changes, legislative efforts, education of consumers (and agents and home office people), etc.

Given those guidelines, and given the characteristics of the ideal product which I mentioned earlier, what is an example of such a product? Here is one possibility, which might be called an "Instant Estate" (simply a rough idea about an approach, not what any company is planning at this time, so far as I know):

1. Benefits included:
   a. Death benefit - The amount payable at death is some multiple of then current income, selected by the client. It changes automatically as salary changes.
   b. Disability income benefit - The monthly income benefit payable at disability is some percentage of then current income selected by the client, and changes as salary changes.
   c. Disability waiver benefit - Also triggered by disability, the waiver benefit continues the premium payments at some percentage of what was being paid in the month before disability.
   d. Asset accumulation fund - This fund is invested in a combination of investment types selected by the client, accruing with interest and/or dividends. It is essentially a "cash value", serving as part of the death benefit, or ultimately as the value at settlement.

2. Premium amount payable:
   a. Determination of total premium - The premium payable is some percentage of current salary selected by the client, and changes as salary changes.
   b. Premium for death benefit less asset accumulation fund - Equal to a yearly renewable term rate applied to the difference between the death benefit and the asset accumulation fund.
   c. Premium for disability income benefit - Equal to a "yearly renewable term" rate for DI applied to the current amount of DI coverage.
   d. Premium for disability waiver benefit - Equal to a "yearly renewable term" rate for DI applied to the current amount of waiver coverage.
   e. Increase in asset accumulation fund - That portion of the premium not required to pay for the life, disability income and waiver coverages is added to the fund for investment.
   f. Drawing on fund - If the total premium paid in a year is not enough to pay for the life, disability income and waiver coverages, the shortage will be taken from the asset accumulation fund.

3. Investment of the fund:
   a. Type of investment - The client may select one of, or any combination of, several investment types offered - bonds, stocks, real estate, portfolio with minimum guarantee, etc.

4. Initiation of program, and changes:
   a. Initiation - When the program is set up, the client selects levels of coverage and premium payment which are linked to salary levels, and to certain events which normally indicate changed needs. For example, the death benefit may be set at 3 times annual salary plus $3,000 per year per minor dependent for the years remaining to age 22; the premium payment may be set at 5% of the first $10,000 of annual salary, plus 10% of the next $10,000, plus 15% of salary above $20,000 - whenever those levels are reached.
   b. Changes in salary, number of dependents - The coverage and premium levels for these events have been predetermined and so do not require new evidence of insurability. Note that this approach is responsive to inflation and other economic conditions to the extent that salary reflects them.
   c. Changes in multiples of salary - If the client requests a pattern of coverages higher than that previously in effect, then new evidence of insurability may be required.

5. Service and financial counselling:
   a. Annual review of program - Each year at a specified time an agent/financial counsellor will meet with the client to review the program and make necessary changes.
   b. Interim changes - If the client wishes to recognize interim changes, e.g. for a salary change or a new dependent, this will be done.

6. Unanswered questions and problems:
   a. What about the agent? Would he/she enjoy this greater emphasis on service and lesser emphasis on finding clients? Of course, "finding" would still be important.
   b. Can compensation levels be set at an adequate level to cover the more frequent personal contacts with the client? Presumably these contacts would produce more business and foster a strong, on-going relationship, which would decrease the lost time of home office and field in the present approach.
   c. Would state insurance regulations permit this?
   d. Would life companies lose the tax-free internal build-up of reserves and suffer double taxation? This would be a disaster, as life insurance companies attempt to compete with other institutions which offer savings services with far lower tax burdens.
   e. Does the client really want that kind of service? Presumably so, but we can't take it for granted.
   f. Can a fine line be drawn between discouraging whimsical transfers from one company to another on the one hand, and making the client feel too "locked in" on the other?
   g. Can anti-selection be avoided in the selection of investment types?
   h. Can mortality anti-selection be avoided in the automatic increase of coverage for changes in salary and number of dependents?

i. Can variations of this approach be provided for situations in which the amount of death coverage is critical and/or follows a pattern based on other factors, e.g. for a mortgage? Presumably this approach would provide the total program for an individual, some portions of which might be earmarked for those situations.
j. Given some desirable new approach, how can we get "from here to there"? Can it be evolutionary? Can it include existing policies in some way?

At this stage, an approach of the nature just described may not seem feasible, perhaps even ridiculous. However, the current approach also has serious problems, and is not nearly so appropriate as it was in times past. If there is a better way, let it be sought and may it be found -- and let it be to the credit of our industry that we are the ones to find it and to provide it for the consumer.