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ORDINARY—NEW PRODUCTS

A discussion of new individual product developments designed to meet the conditions in today's market. This would include underwriting, administrative, and technical problems on such new products as life cycle policies, "low cost" life, index-linked policies, or policies with special cash values, e.g., first cash value equals premium.

CHAIRMAN DONALD R. SONDERGELD: The wording on this topic in the program for this meeting was rather general. I have, therefore, asked the panel to discuss the following specific questions relative to the above:

1. What are the significant differences in market conditions that exist today, compared with those of the past?

2. What characteristics typify the "best" products currently being sold?

3. What's happening in new product development?

4. What will tomorrow's new products look like, and why?

MR. JAMES C. H. ANDERSON: These brief introductory remarks are intended to set the stage for our ensuing discussion of "New Individual Product Developments Designed to Meet Conditions in Today's Market."

What are the significant developments in market conditions that exist today compared with those of the past? My counterpart on this panel at the Los Angeles meeting of the Society was Wilfred A. Kraegel, Associate Actuary of the Northwestern Mutual Life Insurance Company, and I have had the advantage of reviewing his thoughtful presentation on market conditions which I recommend to you all. His thoughts on the subject have contributed significantly to my own.

Much could be said on the subject of changed market conditions; so much, in fact, that it is essential to limit the discussions to an identification of the changes most likely to impact the life insurance industry and its products.

First, there are the changes of a social nature. Changes in attitudes towards marriage and the family are perhaps the most fundamental of these. These changes are manifested in an increase in the number of single and divorced persons and a decrease in the number of children in the average family. Changes can also be noted in social attitudes which play an important role in motivating people to provide for their own and their families' security. I see evidence of a decline in the desire for self-reliance in the increasing dependence upon employer-sponsored and Government-sponsored security programs. Changes are also apparent in the public confidence in institutions ranging from Government to financial companies which must have a negative influence on the value attached to long-term contractual promises, such as life insurance policies. Changes are also notable in the general level of education of the public at large and, arguably, an associated increase in the ability to evaluate critically our products and their cost.

Second, there are the changes of an economic nature. Perhaps the most important of these is the significant increase in family income levels, the growing economic importance of working women, and the associated trend towards two-income families; clearly, the typical family today can afford and needs more life insurance protection than ever before. Major changes are also apparent in the much higher interest rates prevalent today and in the accelerated rate of inflation, both of which impact the motivation to save and the choice of savings vehicle. Finally, there is the much-increased complexity and interdependence of our economic activities with increased risk of instability and economic dislocation, an example of which is the present high level of unemployment.

Third, there are the changes relating to the industry itself. Competition for savings among various financial institutions has intensified; the recent and continuing experience of the life insurance industry with increasing policy loans and the recent experience of the thrift institutions with disintermediation have raised new problems in the area of investment management for both kinds of institutions and have affected adversely their competitive position in the savings market. Except on tax-qualified products, life insurance companies are incurring a progressively-increasing tax burden on investment earnings and, unless legislative relief is obtained, this trend will accelerate as the 10 - for - 1 rule is applied to progressively wider differentials between earned and valuation interest rates. Maintenance expenses, which have remained stable for many years despite inflationary pressures, are now rising significantly as the rate of inflation has overtaken economies of scale in computerization; if present trends continue, this will represent a major industry problem.

Finally, there are the changes of a political nature. Government-supported benefits have increased dramatically in both scale and scope and now include built-in inflation adjustments that ensure that the trend will continue at least for the foreseeable future. Consumer and environmental interests of an organized nature represent a major new political force which has already altered our national priorities. A major result of these political changes is reflected in the increased level of taxation, particularly Social Security, state and local taxes.

What kind of market have these changes made and how should the life insurance industry respond to it? I see today's market as more sophisticated and more cynical than its predecessor; I also see a market with more need for our products and more ability to pay for them. To succeed in this new market environment, I believe that the life insurance industry must reexamine its products and its method of operation. Greater emphasis, in my opinion, needs to be attached to product flexibility to better serve the more rapidly changing needs of the individual. More importance is likely to be attached to short-term benefits than has traditionally been the case with life insurance products; the tax efficiency of our products (from both the buyer's view and the company's view) becomes increasingly important in an environment of increased taxation. Traditional investment policies may require reexamination to improve the competitiveness of our products or to meet their altered needs; and perhaps most importantly, the traditional life insurance delivery system needs to be reexamined if the industry share of the savings market is to be maintained or increased.

MR. JEAN N. LEFEBVRE: Before getting into the presentation of some of the new products that have been introduced over the past few years, it was felt that the following question should be asked, "What characteristics typify the 'best' products currently being sold?"

To simplify the question we will assume that we want the "best" for the policyholder as the "best" product for the agent and/or the company is sometimes the worst for the policyholder.

The "best" product will have to:

1. give the best value for each dollar spent.

2. be best suited to the policyholder's need.

In participating policies, value received for each dollar spent is dependent upon events occurring after issue, thus it is very difficult to judge in advance. However, everything else being equal, the best value will be obtained from the companies that most effectively control sales and head office expenses and whose products are properly designed and administered. For the policyholder's own benefit, levels of sale and head office expenses have to be sufficiently high to attract and retain competent people, but among different companies there will be substantial differences in the amount of wastage of the policyholder's money spent on these expenses. The influence of this factor in the cost of participating policies will be very hard to predict, but it will be more easily recognizable in nonparticipating policies.

It may be easier to recognize proper design and proper administration of products. Examples of poor design are a policy with early cash values substantially in excess of asset shares so that persisting policyholders have to pay for the extra cost of early lapses, or a policy could be so complicated to administer that high extra expenses would render it uneconomical (assuming that each type of policy carries itself). The most obvious areas of improper administration would be underwriting and claims; here again, the honest average policyholder would have to pay for the cost of sloppy underwriting and/or mishandling of claims.

As our industry is trying to design products to meet a great variety of needs and situations, there will necessarily be many products that will qualify as "best" depending on the circumstances.

Therefore, it becomes important that the policy be best suited to the policyholder's need. In this age of consumerism, it seems that many surveys reach the conclusion that the public knows little about products sold by our industry and no complete tool has been developed to permit the public to fully analyze and compare our products.

By simplifying policies and by restricting the number of different policies to the least possible, our industry would better help the policyholder to choose what suits him best. If the policyholder needs life insurance, we should make it available to him at the lowest cost. If he wants a savings program, we should give him a savings program that will let him know where he is going. Too many savings programs break even after six, seven or eight years and give a reasonable rate of return only in the very long run, but in the very long run the policyholder is dead.

Therefore, to me, the "best" products are the simplest products that will make it easier for the policyholder to know what he is buying; I am suspicious that people who make it more complicated have something to hide. The "best" products have to offer a good balance between return to policyholder and dollars available for commissions, expenses and profits. I wonder if there are many clients' problems that a competent salesman could not solve with a good whole life policy, a good short-term policy (hopefully renewable) and a good pure savings policy (plus the usual accidental death and disability riders and a guaranteed insurability rider for large amounts).

MR. RODNEY R. ROHDA: I will briefly describe six product innovations which currently are receiving attention.

1. Life Cycle

The life cycle concept involves the use of a single insurance policy in place of a series of traditional policy forms, which provides virtually limitless flexibility in the level of coverage and premiums. As the policyowner's insurance needs and financial resources change, this single life cycle policy can be adjusted to accommodate them.

Up to this point, the life cycle concept has been more a topic of conversation than a subject of actual development activity. Bob Hunstad of Minnesota Mutual, who was a member of our counterpart panel for last month's Society meeting in Los Angeles, sent a questionnaire regarding the life cycle policy to 86 of the largest life insurance companies and received 74 replies. Only two indicated that they currently offer a life cycle policy (including Bob's own company). Three said the policy is on the drawing board. Eight indicated an interest in developing such a policy but have not yet started any work on it. Thus, only 13 of these 74 companies have shown any active interest in the concept.

Those who responded to the questionnaire were asked to indicate their opinions regarding the concept's major problems. From a home office standpoint, tooling-up costs and state insurance department approval problems (particularly with regard to current valuation and nonforfeiture laws) were often cited as major handicaps. From the consumer standpoint, problems in the layman's understanding of the concept and in providing acceptable ongoing service were felt to be substantial. Also, the problem of defining an acceptable compensation basis was frequently mentioned.

Despite this variety of problems, some companies seem to be making this concept work. Bob Hunstad reports that the Minnesota Mutual has been marketing a life cycle policy since 1971. This policy allows for changes, both up and down, in the face amount and/or the premium within the same policy contract. This policy now accounts for 25% of that company's total sales by number and 15% by amount. All but six of the jurisdictions in which this company does business have approved this policy.

2. Section 79 Policies

There has been a substantial heightening of activity within the past two years with respect to various policies designed to fall under Section 79 of the Internal Revenue Code. This Section allows premium payments for group term life insurance to be excluded from an employee's taxable income. By tailor-making an individual permanent policy, it appears possible to obtain what is essentially group insurance tax treatment for a portion of the premium. This is done by identifying in the policy that part of the total premium which represents the increasing term cost, which then is eligible for deductibility. Much of the marketing activity in this area has been focused on cases involving less than ten lives in small companies. There is still a great deal of controversy in this area regarding whether the use of medical evidence complies with both the letter and spirit of Section 79. Some clarification from the IRS on this point is expected in the near future.

3. Exchange Option

Basically, this option provides that an in force permanent policy may be exchanged on an original age basis to cover a new insured. Usually there is no extra charge for including this option in a policy, or if there is, it is nominal. The new policy can either have the same reserve or the same face amount as the original contract. Full evidence of insurability is required, and the date of the new policy will be the same as the original date, or the new insured's birthdate if later. Three approaches have been taken to this option.

The first is the dowry option. This provides that, upon marriage of an insured female, her policy may be exchanged for one on the life of her husband. Because of recent sex-discrimination rulings from certain states, this option must now be extended to both males and females if it is to be offered at all.

The second approach is to limit this option to policies issued in connection with corporate-owned keyman or cross purchase partnership situations. I know of three larger companies that have adopted this approach.

The third is a generalized exchange provision which is included in all policies. To my knowledge, two major companies have adopted this approach.

While all companies which currently offer versions of this option require evidence of insurability at exchange, one company, for a time, issued a dowry option for a small extra annual premium which did not require evidence. Before long, it became obvious that substantial antiselection was taking place and the option was withdrawn.

Since complete evidence of insurability is required at exchange, the new policy will have select mortality from the point of exchange which will not be reflected in its pricing structure. However, these additional mortality gains will at least be partially offset by the new underwriting and issue expenses. For policies issued at the younger ages and exchanged during early policy years, these expenses exceed the mortality savings. However, the opposite is true for policies issued at higher ages and exchanged in later policy years. One company offering this provision pays a one-time-only commission of 40% at the point of exchange, but currently, no other company pays any new compensation at exchange.

4. Joint Life

The joint life policy, which pays a death benefit at the first death among two insureds, is a concept which has been around for a number of years. But recently, there has been renewed interest in the concept, particularly for the mortgage market. This appears to be a reflection of women's changing role and the growing prevalence of two-income families.

5. Deposit Term and Split Life Policies

These have been discussed at previous Society meetings. When they were first introduced, some believed that they could become major factors in the marketplace. While a few companies seem to be experiencing at least moderate success with them, neither policy seems to now command a significant market share.

6. Sixth Dividend Option

On April 7, my company, the New York Life, introduced a Sixth Dividend Option - Whole Life Additions. Initially, we are making it available only with Whole Life policies. Instead of purchasing single premium insurance as is done with the traditional paid-up option, the first dividend under this new option will be applied at net rates to purchase an amount of Whole Life additions with the same issue age as the basic policy. All succeeding dividends applied under this option will first pay the net annual premium for the previously acquired additions and any balance will be applied to increase the amount of these additions.

This new option provides considerably larger death benefits than paid-up additions for a substantial number of years. For example, for a $10,000 Whole Life policy issued to a male, age 35, the Whole Life additions at the end of the 10th year will be $1,914 on our current dividend scale, which is almost 2½ times the corresponding illustrative paid-up addition total of $783. Of course, because of these greater amounts of protection, the cash values for Whole Life additions will be somewhat less than for paid-up additions. However, it is not until the higher attained ages that the difference becomes substantial.

If the policyowner decides to change to some other option after having elected the Whole Life addition option, or if the dividend scale is cut substantially, then the amount of Whole Life additions will gradually decrease on each anniversary thereafter. The decrease on each anniversary will be determined so that the surrender value will be sufficient to pay the premium for the next year on the remaining additions.

MR. LEFEBVRE: One of the new products mentioned in the program for this session is the "Low-Cost" life policy. This policy is basically a whole life non-par policy with a low initial premium but with the unusual feature that the premium can be increased or decreased in the future.

In the policies that I have seen, the initial premium will be 5% to 10% lower than the competitive whole life non-par rates on the market. However, the policy says that the company reserves the right to increase the premium up to a maximum shown in the policy, at any time after a short initial period (three years or so); this maximum will be 20% to 30% higher than the initial premium.

In the introduction of this product to its salesmen, one company said: "In practice, changes in premium will probably be made as often as dividend scales are changed ..." This statement spotlights the similarity between a low-cost non-par and a par policy; the main difference seems to be that changes in the low-cost premiums will only be made to reflect changes in expected future experience and not to reflect past profits and losses.

Where the actuary has to remain conservative and worry about long-term rates of interest, mortality and expenses in the calculation of the usual non-par rates, he can now afford to establish initial rates for the low-cost policy on current experience and adjust them later, up or down, as changes occur in short-term expectations.

Particularly in periods of wildly fluctuating rates of interest as we are now experiencing, this type of policy may be the solution to the problem of selling and retaining a non-par policy that will be satisfactory to the policyholder and profitable to the company. My main concern is that, even if the salesman has done a good job of explaining the policy and has emphasized the possibility of increasing the premium, there may be many misunderstandings and unhappy policyholders. There is also the danger that some salesmen will not do a good job of emphasizing the variable premium aspect. I do not think that even careful wording of the policy will be effective in avoiding misunderstandings; however, we have found that letters sent directly from the head office to the policyholder at the time of issue, are much more useful in highlighting the negatives (in a positive way).

As the Canadian member of this panel, I would like to spend a few minutes on new products that have received great public acceptance in Canada. Section 146 of our Income Tax Act permits the deduction from income, of contributions made to qualified registered retirement savings plans (there are obviously rules and regulations on maximum amounts, age, type of plans, etc...). Although this legislation has existed for more than 15 years, the amounts invested in such plans have grown spectacularly over the last few years. Such plans can be obtained from trust companies, mutual funds, life insurance companies, and since last year, banks. Until a few years ago, the great majority of registered plans offered by life insurance companies provided margins for very high first year commissions and expenses and consequently, low and even zero first year cash values. Many of these plans contained a mixture of life insurance and savings. Such plans are still being sold and will obviously create more than their share of public discontent and well-deserved bad reputation.

In an effort to better serve the public, many companies are now offering pure savings plans with lower commissions and high guaranteed rates of return. Typically, the policy will state that current contributions will accumulate at a compound rate of interest (8% to 10% currently) guaranteed for the next five to ten years. At the end of the original period, the accumulation will continue at the then current rate. Normally there will be a surrender charge on termination, but many companies will waive it if the accumulated funds are used to purchase an annuity with them; typical first year commission rates will vary from a low of 3% for the single premium type of product to a high of 40% for the annual premium type.

Some companies have been most successful in attracting savings with such policies, but as we are in competition with trust companies and banks that do not have a front-end loading, you and your salesmen must be ready to live on smaller margins.

MR. ANDERSON: In my introductory remarks, I stressed the importance of greater emphasis on product flexibility to better serve the more-rapidly changing needs of the individual. The purpose of this presentation is to examine some of the efforts the industry is already making in this area.

The products I propose to discuss are ones which afford flexibility either by adjusting benefits or premiums or both. They fall into three categories:

1. Index-Linked Products

   These are products that link benefits (and possibly premiums) to an external index, such as the consumer price index.

2. Investment-Linked Products

   These are products that link benefits (and possibly premiums) to an investment index, such as the unit price of a particular fund of assets or a published stock exchange index.

3. Flexible Premium Annuities

   These are products with flexible premiums which provide benefits of the accumulation type either at a guaranteed rate of interest or in a unit fund.

The concept of a life insurance product with benefits linked to the consumer price index is an appealing one; logically, premiums should also be linked to the same index but this aspect of the concept is less appealing. Although both concepts are simple and easily understood, the technical difficulties associated with the design of such a product are formidable. The fundamental problem is that there is no existing investment medium which can reasonably be expected to track the consumer price index and, consequently, the assets and the liabilities of the issuing company are almost certain to be subject to different growth rates. The result is that such products must be priced on the basis of the conservative assumption that liabilities will increase more rapidly than the assets and the resulting prices are unattractive when compared with traditional fixed dollar products. Other technical problems relate to compliance with standard nonforfeiture and valuation laws which do not readily lend themselves to a situation where a contract's benefits and, possibly, premiums are not predetermined. To demonstrate that a contract complies under all conceivable circumstances is a next-to-impossible task and, consequently, such products as have been offered usually impose a ceiling on the annual or cumulative increase allowed.

Investment-linked life insurance is probably better known in the United States as variable life insurance. The concept of linking benefits and possibly premiums to an investment index neatly solves the problem of ensuring that the assets and liabilities will change in concert. The problem is that the resultant fluctuations in benefits and premiums are not logically related to the needs of the buyer and his probable ability to pay, as is the case with products linked, for example, to the consumer price index. Accordingly, investment-linked products while overcoming a major technical problem lose significantly in buyer appeal. The technical problems associated with investment-linked products remain formidable since these products are regarded as securities and since it is proposed that they be regulated as such. Until the regulatory position is resolved, it is unlikely that products of this type will be offered on an individual basis. It is worth noting that variable life insurance enjoys a significant share of the individual life insurance market in other countries where the regulatory environment is favorable.

The creation of individual retirement accounts under the pension reform legislation of 1974 and the liberalization of contribution limits for self-employed retirement annuities have contributed to a substantial increase in the market for annuities with flexible, rather than fixed, premiums. These products have existed for many years in various forms, but the number of companies actively offering such products has increased significantly and can be expected to increase further. Flexible premium annuities generally provide for the accumulation of a specified percentage of each premium either at interest or in a unit separate account. Where a unit separate account is used, the contract is the familiar variable annuity.

Probably because of its close resemblance to the variable annuity, the flexible premium annuity is generally priced on a basis that follows fairly closely the pricing basis of variable annuities. Customarily, the load is a level percentage of premium in the range of 8% to 10%; the rate of interest credited is generally guaranteed to be not less than the valuation interest rate and excess interest is credited at the discretion of the company; some contracts include short-term guarantees that the excess interest will not be less than a specified rate for the first five to ten years. As a typical example, one company offers a guaranteed interest rate of not less than 4½% for the first five years, not less than 4% for the next five years, and 3½% thereafter, and has a currently credited rate of 6 3/4%.

Instead of a level load pattern, some companies apply a higher deduction to the premiums paid in the first policy year than to premiums paid in subsequent policy years and others provide for a higher load on the cumulative premiums paid up to a maximum of, say, $5,000. Some contracts provide for surrender charges related either to the time the contract has been in force or to the cumulative amount of premium paid in.

Compared to traditional life insurance and fixed premium annuity products, flexible premium annuities carry much lower expense charges, and consequently much lower commission rates. Some companies using a level load have adopted a level commission scale and, thus, the contract becomes a serial single premium contract for commission purposes. Other companies pay commissions in the first contract year in excess of the load which presents a problem in distinguishing between what is actually an annual premium contract and a single premium contract. Companies which relate the load to the cumulative amount of premium paid are better able to relate the amount of commission to the amount of load received. Since the standard nonforfeiture law does not generally apply to annuities, these values on flexible premium annuities remain unregulated in most states. Although the standard valuation law does apply to such contracts, there is some uncertainty as to the method of its application and many companies are holding reserves on these policies equal to the cash values.

Flexible premium annuities are ideally suitable for providing retirement benefits under practically any plan where individual policies are suitable. Their application to the individual retirement account and self-employed retirement annuity markets is clear, as is their application to corporate pension plans of the defined contribution type. They also may be used for corporate benefit plans of the defined benefit type. For corporate pension plans, life insurance benefits can be provided where required by annual term riders; and the flexible premium feature avoids the problem of multiple policies, an important consideration given the concern over rising maintenance expenses.

Because of the low commission structure, flexible premium annuities are not popular with agency organizations and there is considerable resistance to the concept of applying these plans to the pension trust market generally. For individual retirement accounts and certain other applications, there is probably merit in the argument that commission rates are too low.

Unlike index-linked and investment-linked contracts, which are mired in technical and regulatory difficulties, flexible premium annuities are very much a part of the current market scene and seem destined to increase in importance notwithstanding resistance to the significantly lower agent compensation provided.

CHAIRMAN SONDERGELD: I have reviewed two nonparticipating products that are being sold where the first year cash value equals the premium.

It is important to note that both products are distributed through the mail. Rather obvious minimum deposit type problems could arise if such a product were sold by an agent who received a commission.

Neither product uses a policy fee in the rate structure, so that the cash value can be exactly equal to the sum of the gross premiums irrespective of policy size. For the same reason, the annual premium is 12 times the monthly premium, and the quarterly premium is three times the monthly premium.

The first product is a Life Paid Up at Age 65 policy. The cash value at age 65 is based upon 1958 CSO mortality and 2½% interest and equals $736 per thousand of face amount. The issue age range is 0-55, inclusive. Cash values at all attained ages prior to age 65 are exactly equal to the sum of the premiums. For all issue ages, the increase in the cash value from attained age 64 to age 65 is slightly greater than the premium. An obvious constraint on the gross premium level for a product with this cash value design is that the gross premium for each issue age may not be greater than $736 divided by the number of years in the premium payment period. This product is fully underwritten.

In comparing the annual premium rates for this high cash value Life Paid Up at Age 65 policy with those my company charges for one that has minimum cash values, I noted the high cash value policy had only slightly higher premiums, except for issue ages 46-55 where they were actually lower.

The second product I reviewed is a monthly premium endowment contract. The cash value at the end of any month is equal to the sum of the monthly premiums that have been paid. The policy matures as an endowment at the last policy month where the cash value would be less than or equal to the face amount. For example, at issue age 35 it matures after 37 years and 4 months.

In all cases, maturity occurs in the 69-73 attained age range. The rate structure appears to be similar to that charged for a fully underwritten non-par Endowment at Age 70 contract.

One interesting feature of this product is a modified death benefit in the first two policy years as there are no medical exam or health questions contained in the application. There is also a maximum amount that may be applied for. This is $15,000 at the low ages, grading down to $5,000 at issue age 65. If death occurs as a result of sickness or disease during the first two policy years, the death benefit is a return of premiums with 5% interest. If, however, death was accidental, then both the face amount and return of premiums with 5% interest is paid. After the second year, only the face amount is paid irrespective of the cause of death.

In summary, both of these high cash value products were designed to be sold through the mail. The magic appears to be that higher benefits on lapse, and the extra mortality expected in the case of the endowment product, are offset by lower acquisition costs over the life of the policy.

Both products provide for policy loans. If these policies are fully loaned, the only source of income is the policy loan interest. I suspect an actuary would want to carefully test the sensitivity of these products to variations in the lapse and mortality assumptions used in developing the gross premium rates.

MR. ROHDA: The last portion of our prepared presentation asks what tomorrow's new products will look like and why. One fundamental question for the future centers on the degree of the consumer's interest in individual life insurance for providing death protection. On the positive side, I believe we will see a continuing growth of awareness of the actual amount of insurance protection which is necessary to provide adequate family security. This, combined with the ever present problem of inflation, should exert a positive influence on the need for individual protection.

However, a potentially powerful counterbalancing force will be the continuing growth of group and governmentally provided insurance protection. These latter forces might turn out to be far more powerful than most of us can imagine and could have an extremely disturbing impact on a major portion of our business as we know it.

While the future for individually provided death protection might hold some substantial problems and uncertainties, there appear to be signs of a resurgence of the role of individual insurance in the accumulation of living values.

The performance in recent years of equity investments has, at least for now, tarnished the glamor of these investments and partially restored the public's respect for permanent life insurance as an accumulation vehicle.

Coupled with this, the recent development by some companies of "current money market" annuities and side funds has added a new dimension to our products and has been favorably received by the public.

Of course, equity investments will continue to be a part of many people's financial programs. Our industry's expensive and frustrating movement into equity products has certainly not been as successful as we would have hoped.

However, it has expanded our market basket of products and no longer can life insurance products and direct equity participation be considered as mutually exclusive concepts.

But what about specific products? Will the life cycle policy become the dominant force? In the near future, I doubt that it will. For one thing, we must realize the dangers inherent in a situation where the actuary's ability to invent a sophisticated product such as this might far exceed the consumer's ability to understand it. Also, if its implementation depends on a major restructuring of our compensation system, then companies with large, closely-controlled field forces will have substantial problems in adopting it. Perhaps some new companies or a newly established branch of an existing company will find successful ways of marketing this product, and a gradual growth of this concept's influence will result.

Perhaps I am being too pessimistic about the overall prospects for life cycle policies. However, I believe the future will reveal that various aspects of the life cycle concept will be adopted in new products and procedures. For example:

1. The establishment of a single billing account, with a monthly account service charge, for policyowners with a number of policies in one company. This can be a first step towards shifting both the company's and the consumer's focus away from the individual components of insurance protection and towards the overall package of benefits provided.

2. The liberalization and expansion of the existing guaranteed policy purchase option, with the possibility that this option can be merchandised as a product by itself.

3. A new approach to the design, underwriting, and administration of small-size policies. If the private sector fails to effectively serve this market, we all know who will fill it for us. But at the same time, we must obtain reasonable financial results from this market. To do this, it seems that some major changes might be necessary. One can't help but wonder if some form of mass marketing wouldn't have great potential here.

4. Building "anti-lapse" features into policies through such things as:
   some version of a "stop and go" premium feature for life insurance policies and
   continuing variations on the deposit term theme.

To conclude my remarks about the future, I feel it is important to emphasize that we should not focus only on what products actuaries might be able to invent. Instead we must realize the close tie between products and the methods used to market them. Most insurance today is still sold by commission-compensated agents who sell primarily for just one company. Our view of new potential products will necessarily be restricted if we think of only those which can be sold by this type of field force. To be truly innovative and to break into potentially valuable new markets and services, we must realize that this might well involve changing both the product and the marketing method.

MR. J. ROSS HANSON: The life insurance policy currently being issued in the U.S. has certain rigidities. The premium is fixed at issue and is payable in specific amounts at specific times. Failure to make timely payments in the correct amount can be cause for termination of the policy or for reduction in the death benefit provided. The amount of insurance is determined on the date of issue and is not adjustable without a reformation of the contract. Withdrawals may not be made under these policies except as interest-bearing loans with the insurance company holding the policy as collateral, or as partial surrenders (this privilege is not always available but is usually provided by Company practice and involves a reformation of the contract). These strictures tend to make the policy unsuitable to the needs of many policyholders.

The life insurance policy is a contract which is expected to be in force for many years. Yet, on occasions, a policyholder may wish to pay less than the amount called for or to make payment at a time other than when the premium is due. On occasion, a policyholder may wish to prepay premiums. And most important of all, it may be desirable to increase coverage just at a time when the policyholder could not or would prefer not to increase his dollar outlay for insurance. There seems to be no reason why payment for life insurance should not be flexible enough to meet the changing financial situation of the policyholder.

During the lifetime of the insured person, there are many occasions when the amount of insurance should be either increased or decreased. Increases are usually necessary when increased family or business responsibilities arise. Decreases may be appropriate when the same responsibilities diminish, as when the children are grown or one's home becomes paid for. Also, increases may be needed merely to meet changing economic conditions -- a $10,000 policy bought less than 7 years ago will only provide $7,000 worth of goods and services today.

Changes in amount of insurance are effected today either by purchase of new policies or by surrender of existing ones in whole or in part. This is a very inefficient and expensive process. Premiums under new policies must reflect the attained age of the insured and his current insurability status. Acquisition expenses must be paid by the company and borne by the insured in his new premium along with the cost of maintaining the additional policy.

The cash value of a life insurance policy is a valuable asset, but policy loans can only be made, using this asset as collateral, by making application and awaiting processing. Interest is charged on the loans (a perfectly correct procedure, of course). However, there are many times when a policyholder may wish to borrow for a short period; it should be as easy to make such a withdrawal and repay it as it is with a bank savings deposit.

The public should have a life insurance policy which, once issued, is the only policy the insured will need for the rest of his life -- a life-cycle policy. Premiums should be payable at the convenience of the insured and withdrawals and repayments should be simple transactions. The amount of insurance should be adjustable to meet the needs of the insured and economic conditions.

The current life insurance policy is also rigid in its ownership provisions and the insuring clause. The policy is owned as a whole, and the insured is one person. When it is desired to vary this situation, riders are added with cumbersome provisions for benefits on the life of the insured or the spouse or children, and in some cases, for a special succession of ownership.

There does not appear to be any reason why several persons should not be insured by the same Ordinary life policy or package of coverages under which if desired, ownership and beneficiary arrangements would be associated with the various insurances.

And finally, the insurance policy is limited by a further sort of rigidity which is the limitation on the investment policy of the insurance company. The notion of the insurance policy as a long-range contract implies the assets of an insurance company should be largely limited to investment in debt securities and mortgages, putting severe limitations on the development of the life insurance policy as a flexible financial instrument.

The purchase of life insurance is not merely the purchase of a commodity like a house or a car; it is part of the insured's total arrangement of his financial affairs. We ought to be able to develop and market a life insurance contract which would, for most insured lives, be a large part of their total financial planning.

In the past few years, there have been three interesting ideas brought forth, all of which are concerned with the various rigidities discussed above:

1. The "Flexible Plan" -- This is the name which the originator, Mr. Maurice H. LeVita, A.S.A., F. C.A., M.A.A.A., gives to his idea in the papers he has presented on the subject to the Conference of Actuaries in Public Practice. This concept:

    a) allows the policyholder to deal with a single insurance company for all his and his family's life insurance needs;

    b) reduces the cost to the policyholder of multiple acquisition and issue expenses associated with the issue of a new policy whenever his insurance needs change;

    c) permits the policyholder to pay premiums within certain limits when he wishes and in the amount he wishes;

    d) allows the policyholder to adjust insurance amounts to meet his needs and economic conditions;

    e) eliminates such traditional encumberances as interest on policy loans and making application for policy loans.

2. Separate Account -- This concept:

    a) enables the policyholder to participate immediately in the investment income on the assets underlying his contract. It is very difficult to predict interest rates with any degree of confidence, so pricing life insurance benefits becomes commensurately difficult, particularly for nonparticipating insurance, although the same problem is present in setting dividend scales under participating business;

b) allows the "small investor" to participate in an investment program whose potential yield is probably greater than most programs available to him;

c) provides relief for the life insurance company from the statutory investment restrictions which tend to limit yields payable to the policyholder. The assets in a Separate Account may be invested in common stock or in other securities or, if the investment annuity approach is used (a kind of separate account), in any approved investment medium selected by the policyholder, such as savings and loan shares, mutual funds and certificates of deposit.

3. Split Life -- This concept:

   a) permits the policyholder to designate one or more persons to be insured at very low term rates under one financial package, and

   b) provides the flexibility to determine the appropriate ratio of insurance to investment for each policyholder.

These three concepts can be merged into a single insurance package -- I call it the "Varisplit" for convenient reference -- which would be the flexible life-cycle financial instrument needed to avoid the rigidities discussed above.

Under the Varisplit package, the owner would decide on an initial periodic payment to his program, the initial amount of insurance, and the distribution of this insurance among his and other lives. All of this would arise from financial counselling by a life insurance agent and would be subject to such underwriting requirements as the insurer prescribes and to a reasonable actuarial relationship between insurance and the periodic payment.

Payments would be made to the insurance company from time to time and in such amounts as the owner chooses, although during the first contract year it would be advisable to require that the total periodic payments be paid (in order to defray the acquisition expenses).

Upon receipt of a payment, the company would deduct a contractual charge and any applicable premium taxes and the balance would be transferred to a Separate Account for investment.

At regular intervals (annual would be best) the cost of the insurance in the package would be transferred from the Separate Account to the General Account. This cost would be actuarially determined so that the total income of the General Account (charges, cost of the insurance, and the asset charge discussed below) would be adequate to cover the benefits, expenses, and profit goals of the company. The life insurance could be provided in separate policies if there is an advantage to that procedure as far as the policyholder is concerned (ownership, beneficiary arrangement, or taxes) or it could be provided directly within the provisions of the contract.

At regular intervals (weekly or monthly), an asset charge, measured as a percentage of the reserve in the Separate Account, would be transferred from the Separate Account to the General Account.

On the last day of each contract year, the amount of insurance to be in force in the next year on the lives insured would be determined. It could be level or it could be automatically indexed in some fashion. If the owner wished to change the amount of insurance, he could do so upon request, subject to underwriting requirements if the change is a significant increase (guaranteed insurability could be a part of the package); in many cases this would suggest an increase in payments, but this should not be a necessity.

On each anniversary of the contract, the reserve would be adequate to provide the designated amounts of life insurance for defined extended term periods. There would be no lapse of the contract if payments are not made, but it would be necessary to "suspend" the contract and refuse future payments if the extended term period fell below, let us say, three years. If suspended, a contract would be reinstated subject to the appropriate requirements. If the reserve becomes exhausted for any reason, the contract would terminate.

There would be no loans provision. However, the owner could make withdrawals from the Separate Account at any time in any amount consistent with the conditions for suspension. Any repayment of withdrawals would receive the same treatment as other payments under the contract.

The Separate Account would likely be considered an investment company subject to regulation under the Federal securities laws. If this aspect is thought to be too burdensome or inadvisable for any reason, the Varisplit contract could be funded in the General Account, but the desired investment flexibility would be lost.

There are obviously many more facets to this matter, such as agent compensation, merchandising, and compliance with state and Federal regulation to name a few. But the Varisplit approach produces a life insurance product that, according to our research, more than satisfies the three most important parties to any insurance transaction -- the agent, the company, and the insured. The agent, who must be a highly-trained and highly-motivated financial planner, receives fair compensation for his efforts and has a group of policyholders to service which will provide a stable source of future sales and which will persist at a much higher rate than most other comparable groups. The company has a product which will generate a satisfactory yield on invested surplus and will attract top-quality agents. The insured has an insurance policy with all the positive features described that is superior to any other policy of comparable size in terms of cost of benefits provided.

This discussion is meant only to suggest the kind of contract that could be developed to make the life insurance policy into a life-cycle financial instrument which provides great advantages for the insured, the insurer and the financial counsellor. At first blush it may seem unduly complicated; but, in fact, it is a simple and direct contract to administer when compared with the current procedure of issuing and maintaining multiple policies (on various plans) over the lifetime of a "consumer" of life insurance.