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CURRENT IRA (UNITED STATES) AND RRSP (CANADA) DEVELOPMENTS

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CHAIRMAN CLAYTON L. JACKSON: On September 2, 1974 President Ford signed into Law the Act now known by the acronym ERISA. While largely concerned with corporate pension plans, ERISA did not neglect individual retirement plans. Individual Retirement Accounts,now known as IRA's,were established, effective January 1, 1975, for individuals not covered by qualified pension or deferred profit-sharing plans or government plans. ERISA also provides that a lump-sum distribution from an employer's qualified plan received on separation from employment, less any employee contributions, and certain other lump-sum distributions may be deposited in an IRA subject to certain conditions. These are known as "rollovers".

Now, after over a year of exposure to IRA's, we are going to review what we have learned and look at the problems that have surfaced. Comparisons will also be made with Canada's program for individual plans, called RRSP's, which has been in effect since 1957.

WHICH PRODUCTS HAVE PROVED SUCCESSFUL

MR. W. MICHAEL CARTER: Section 408 of the Internal Revenue Code, as added by Section 2002 of the Employee Retirement Income Security Act of 1974, specifies that certain products may be issued by insurance companies as qualified IRA's in the United States. Basically, these eligible products are endowment contracts, retirement income contracts, and annuity contracts. Ineligible contracts are any type of whole life policies. Any company preparing to enter the IRA market must decide which product or products it wishes to sell.

Some companies have entered the market with only endowment or retirement income products, usually the latter. Other companies are offering both retirement income and annuity products. Many companies, however, have offered only annuity products. Because of the significant role annuities have played in this new market, most of my remarks will concentrate on these products.

A few years in the future it may well be said that the creation of IRA's was the best and worst thing that ever happened to the retirement annuity. On the best side, it is certainly true that, because of IRA's, annuity contracts have assumed an unprecedented position in many companies' portfolios. For most companies, the introduction of an annuity product into the IRA market has been an unqualified success. In my former company, for example, new annualized premium from the IRA annuity zoomed to over $3,000,000 in 1975 where in past years annuities had typically only accounted for $500,000 in new premium income.

While some companies have used traditional fixed premium annuities, the major emphasis by the industry has been the development and refinement of flexible premium annuities (FPA). Prior to IRA, most FPA's in existence were typically offered by small companies as riders to life policies, at least in the individual product market. They often had very low early cash values and very high commissions. As the IRA market has developed, however, and the competition from banks and savings and loans has increased, the product development process has brought many changes and modifications in the FPA. Essentially, all major companies have some type of FPA available. On the one extreme is the high-load, high-commission product typical of the pre-IRA FPA's, while on the other extreme are the low-load, or even no-load products with low commissions. The product may provide for completely flexible premiums with no premium required after the initial one and subject only to IRS limitations on the annual maximum. Other types require at least some token minimum and/or some maximum which is a multiple of the initial premium. Still others require some fixed yearly premium with a variable amount over and above the fixed portion. One variation on this latter version is to allow the variable portion's cash value to be transferred to the fixed portion when the total premium for the fixed portion is not received.

Largely because of the competition from banks and savings and loans, guaranteed and projected cash values on these FPA's have reached new heights. It is possible to find projected interest rates of 8% and higher, with guaranteed rates limited only by state-imposed restrictions in the standard valuation law.

While enjoying great success, the FPA has created its share of problems for the industry, not the least of which has been how to administer it. A major concern, however, has been the growing cries from industry critics concerning alleged deceptive practices. One result has been the greater interest by the state regulators in annuity nonforfeiture values and related valuation problems. Several states have adopted regulations fixing minimum values and/or minimum reserve requirements. Where the guaranteed interest rate exceeds the valuation interest rate, several states are requiring a calculation technique that can actually cause the reserve to exceed both the cash value and the death benefit.

Even without regulation, however, I think the marketplace will determine the future course of the IRA product. The competition from banks and savings and loans remains very strong. Pressure from government and consumer critics will continue. As the IRA contract-holder becomes accustomed to the concept, he will become more aware of competitive differences. Because of these various influences I think we will see a high-quality product emerge. It will have level or nearly level expense loadings, very attractive interest guarantees, and extremely competitive projected earnings. Its commission structure will depend directly on the surplus strength and marketing philosophy of the company. The stronger the company's surplus position, the more likely we will see a heaped first-year commission rate, but I would be surprised if this heaped rate can exceed 20% to 30%. If the company does not desire a great strain on its surplus from this product, it will tend to level the commissions in the 3% to 10% range.

The future for IRA sales is very bright in my opinion. It is only a matter of time until the maximum limit of $1500 is increased, and the next logical step is to allow anyone to establish an IRA, even if he is covered by a pension plan. Both of these proposals have, in fact, already been recommended in testimony before Congress.

MR. HAROLD G. WIEBKE: I'd like to approach successful IRA products from a different viewpoint. We have heard and seen much of the competitive product offered by the banks; effective annual rates of return in excess of 8% are repeatedly portrayed in newspaper advertisements, etc. But is the bank product successful? If current statistics on Individual Retirement Accounts have been published, I have not been made aware of them. Certainly, some figures should be available for 1975 shortly. The only figures that have been called to my attention are from a Wall Street Journal article which appeared August 27, 1975. Although, admittedly, prior to the year-end rush, this article indicated that a large New York bank had only 2,000 accounts while a large bank in San Francisco had less than 2,000. In both instances, substantial advertisement had been employed. In the meantime, insurance companies had been eminently more successful. Why? The answer is the delivery system, or lack of it.

Once again it has been demonstrated that nothing succeeds like a motivated salesman! The tremendous IRA market will not be penetrated significantly without head-to-head explanations of the tax advantage of IRA on a largely person-to-person basis. Life insurance companies, through the agency system, effectively provide this delivery of product. Their very success, though, has focused much attention on the product and the elements of disclosure associated with the sale of IRA.

The IRA products and market penetration techniques, then, will develop and mature in an unprecedented fishbowl environment, under highly competitive conditions (primarily between companies). This is good in the long run, and better products will be the result; but the nature of these products perhaps will cause a different marketing thrust that may slow full realization of the tax advantages of IRA by the eligible millions. There is a basic enigma there - whether it is better for fewer people to realize certain advantages over a longer period of time but through "better" products. Be that as it may, I believe the product direction within this fishbowl will be to shave and pare loads with resulting shaving and paring (and leveling) of agent's commissions, with perhaps even a flat fee element. As part of this scenario, market penetration will be acheived only through incidental or simultaneous individual sales, or by mass marketing techniques. The latter would not be effective for large segments of the IRA potential market.

I believe that today insurance company IRA products can be successful if substantial marketing emphasis is applied, and others will have relative success with little or no marketing emphasis. Retirement income type products require not only the higher insurance product commissions as sales incentive, but also a marketing emphasis by the company. These sales, then tend to replace sales that the agent might otherwise make in non-qualified areas, and, accordingly, don't necessarily enhance overall company results. The deferred annuity products, on the other hand, particularly those with relatively level loads (and commission), tend to be sold in addition to an agent's regular sales, in situations where he recognizes relatively simple sales effort is needed. In the latter case, a slower market penetration results but the company (and the agent) may be better off. The customer is or isn't better off, depending on whether insurance in his IRA program would have been a logical and proper part of his financial planning.

RRSP'S GENERAL BACKGROUND

MR. ARNOLD J. SHELL: The RRSP concept was introduced by the Canadian Federal Government in 1957. It was intended primarily for the use of self-employed individuals who were not eligible for membership in a company-sponsored pension plan.

Under the original rules, any taxpayer could contribute to an RRSP and deduct from income:

(a) The lesser of \$2500 and 10% of earned income if he was not a member of a pension plan.

(b) The lesser of \$1500 and 10% of earned income less his pension plan contributions if he was a member of a pension plan.

These limits were raised to \$4000 and \$2500 respectively in 1972, and 10% was raised to 20%.

The intention is that funds will be accumulated in the RRSP until the da of retirement and then will be converted into a retirement annuity. No contract can be registered as an RRSP if it provides for a cash surrender value. Annuities must commence by the 71st birthday of the annuitant and must be payable over the life of the annuitant or the joint lives of the annuitant and his spouse with a maximum guaranteed term of 15 years.

Although registered contracts cannot provide for cash surrender, they can be amended to provide for cash surrender. In this case, the cash surrender value must be included as ordinary income for income tax purposes in the year of receipt. There is no excise tax on these surrenders. In addition, rollovers can occur from one RRSP to another without attracting income tax and without restriction in their frequency.

In 1974, the concept of a spousal RRSP was introduced. Under this concept, a taxpayer can contribute up to his maximum limit towards an RRSP for the benefit of his spouse. Any such contributions are deductible from his own income for tax purposes.

RRSP'S - WHICH PRODUCTS HAVE PROVED SUCCESSFUL

MR. ARNOLD J. SHELL: The stated purpose of RRSP's at their introduction was to provide a method for individuals to provide for their own retirements. The conventional way to do this was through the purchase of an annual premium deferred annuity contract. It was common to have an insurance option with this type of contract so that the most successful product from 1957 to the late 1960's and early 1970's was the retirement income policy sold by insurance companies.

The characteristics of this contract were:

1. High/low commission scale
2. Low early cash values
3. Fixed premiums
4. Portfolio rather than new money interest rates

By the early 1970's, several forces were at work causing the insurance industry to redirect its marketing thrust in the RRSP field. The deduction limit for RRSP's is related to the taxpayer's contribution to his company pension plan if he is a member of such a plan. It became increasingly common for pension plan participants to make supplementary contributions to RRSP's rather than making voluntary contributions to pension plans. Most pension plans in Canada provide for an employee contribution equal to some percentage of salary. As salaries increased, so did pension plan contributions and, as a result, maximum allowable RRSP contributions decreased. This played havoc with those who had purchased fixed-premium annuity products with their RRSP contributions. In some cases, the maximum deductible contribution now fell short of the contractual fixed premium. Existing contracts had to be put on a reduced paid-up basis and new contracts issued. This problem led to the development of Flexible Premium Annuities as more suitable for use as RRSP vehicles.

By the late 1960's and especially with the increase in the maximum deductible limits in 1972, the banks and trust companies became increasingly active in the RRSP field. They found an easy target to compete against in the high-commission insurance company products based on portfolio interest rates. As the competition increased and as interest rates rose, the insurance industry developed new approaches to RRSP's, and today the most successful insurance company products have the following characteristics:

1. Level commissions
2. Level front-end load
3. Flexible premiums
4. Interest credits related to new money yields
5. Segregated side fund options

In some cases, RRSP's written on a group basis have proved successful. These are written on employer or association groups and generally have the characteristics listed above. In most cases, there is some expense saving in using a group approach and so the front-end load is normally at a lower level.

REGULATION PROBLEMS THAT HAVE DEVELOPED

MR. MICHAEL L. SMITH: As those issuers of IRA's are probably now fully, as well as somewhat painfully,aware, the Internal Revenue Service has issued, as of April 6, proposed regulations on disclosure statements on individual retirement annuitities. Such proposed regulations, if and when adopted, will supercede the temporary regulations which were published November,1975. The proposed regulations require, as did the temporary regulations, that a disclosure statement must be furnished to the "benefited" individual for whom the IRA has been established. However, under the proposed regulations, there are changes with regard to the time for furnishing the required disclosure statement.

Under the general rule of the proposed regulations, a disclosure statement must be furnished no later than seven days preceding the date the IRA is actually established. An exception to this general rule permits the disclosure statement to be furnished as late as the date of establishment if the benefited individual is permitted to revoke within seven days of the establishment in cases of certain rollover contributions, IRA's established during the last seven days of the taxable year, and employer-sponsored or employee-association arrangements.

The required disclosure statement would contain three different categories of information:

1. First, a concise explanation must be given of the tax consequences of establishing the IRA, the deductibility of contributions, the tax treatment of distributions,and the tax status of the IRA;

2. Secondly, the proposed regulation has extended the requirements of the temporary regulations to include statements describing the ability to make rollover contributions from one IRA to another IRA and whether or not the IRA has been approved as to form by the IRS. Additionally, where the disclosure statement may be furnished less than seven days preceding the date of establishment, a statement is required to signify that the benefited individual is entitled to return of the entire amount of consideration paid by him without adjustment for sales commissions (loading), administration expenses,or market value fluctuations;

3. Thirdly, the proposed regulations extend the temporary regulation requirements to indicate additionally the net amounts available upon withdrawal at the end of specified years.

Finally, the disclosure statement must indicate the portion of a contribution attributable to the cost of life insurance and of sales commissions charged in any year, expressed as a percentage of gross annual consideration.

Some of the practical problems associated with these proposed regulations, continued from or not encountered under the temporary regulations, are of the following nature:

1. The disclosure statement must be accompanied by a specimen copy of the instrument which establishes the IRA. There have been varied interpretations of this among the issuers of IRA's -- such as a specimen copy of the contract, the application, or a combination of the application and other disclosure material. Apparently no clarification emanates from the proposed regulations. Since,in the majority of sales, as far as life insurers are concerned, the disclosure statement must now be furnished no later than seven days before the establishment of purchase of the IRA, providing the field force with a supply of specimen contracts must be considered burdensome.

2. There is some thought that "sales commissions" is intended to mean the sales administration or expense charge, or loading as it is more commonly known, as opposed to the producer's compensation. If that is not the intended view, then a host of problems becomes apparent.

3. The financial disclosures at the end of specified years of either guaranteed amounts or projections of amounts which can be reasonably made is to be based upon annual contribution of $1. Contracts which provide policy fees, transaction charges, annual administration charges, or combinations thereof,are in somewhat of a perplexing position since such charges generally exceed $1 per year.

4. A number of companies, under the temporary regulation, have been distributing copies of IRS publication Form #590 when the IRA has been established as complying with setting forth in non-technical language the various matters in the requirement. It is hoped that Form #590 will be revised to meet the new requirements of the proposed regulation if adopted, although there has not yet been any official indication of doing so.

I hope there are several members in the audience who will be able to provide us with additional information regarding these proposed regulations.

CANADIAN LIFE INSURANCE ASSOCIATION SELF-REGULATION

MR. SHELL: In the early years of RRSP's, the advertising for them focused on the long-term nature of the concept and on the objective of saving for retirement. Few consumer problems were encountered. With the increased competition in the early 1970's, much of the advertising began to focus on immediate tax "savings" and on high interest returns for short periods of time. This caused RRSP's to be seen by the public more as a short-term investment than as a long-term savings arrangement. Basically, the insurance company products were not and are not appropriate as very short-term investment vehicles, and many consumers began to complain about the insurance company RRSP products that they had purchased.

In order to forestall government regulation in the RRSP field and in order to minimize the incidence of these kinds of complaints, the Canadian Life Insurance Association issued in September, 1974 guidelines for the self-regulation of insurance company RRSP practices. The guidelines are in the form of 12 recommendations. Some of the major recommendations are:

1. In RRSP advertising:
   (a) Tax aspects should be de-emphasized; any reference to tax consequences should be in terms of tax deferral rather than tax savings.
   (b) The conditions of registration should be made clear and no reference to immediate deregistration, surrender or withdrawal should be made.

2. Field forces should be adequately trained in all aspects of RRSP's and in the suitability of various products for use as RRSP's.

3. An "information sheet" should be provided to all RRSP purchasers at or before delivery of the policy. The information sheet should outline the salient features of the policy including cash values, and should give a brief description of the purpose, restrictions and long-term nature of RRSP's.

4. Any surrender charge on a flexible premium product should be clearly described.

5. Applications for RRSP's should request certain information to permit the company to underwrite applicants for suitability.

6. Inconsistencies caused by having essentially similar products which differ primarily in their commission scales should be eliminated.

MR. CARTER: Several regulations could impact this market. The required 7-day free look is a problem in that where does the 7 day period begin. If delivery of disclosure needs to arrive 7 days before issue on a cash-with-app case, you might have to postdate the policy.

Another area to look toward is Group Annuities. The IRS is going to clarify disclosure requirements and the use of Group Annuities in the IRA market. We probably can look forward to the increased use of Group Annuities in cases where the IRA is employer-sponsored or association-sponsored.

MR. WIEBKE: The burden of these disclosure regulations is on the individual. If someone just gives you some disclosure information,you haven't committed yourself one way or another. However, if you sign your name and someone says you have seven (7) days to change your mind, then you start thinking about it. These regulations could be self-defeating.

TAXATION

MR. WIEBKE: I don't believe IRA business has any special implications or problems with respect to the insurance companies' Federal Income Tax. But does Federal Income Tax have implications and pose problems for IRA? The answer is "no more so than any other type of qualified plan in which the insurance company product is sold." However, Federal Income Tax impact limits the interest that can be credited to an annuity contract without incurring a loss to the company, and this,in turn,means companies in certain tax situations can gain a competitive edge over other companies. A company taxed on gain from operations can credit interest at a rate in excess of its current earnings rate without being taxed on the excess while a company taxed on taxable investment income could not.

Companies taxed on taxable investment income and guaranteeing rates in excess of maximum valuation interest over a period of time, who are required to hold reserves which if accumulated at the valuation interest rate would meet the guarantees, are incurring a surplus strain which may afford some tax relief. Thus, such a company in a good surplus position may,in effect,decide to "invest" surplus in an IRA annuity featuring attractive guarantees.

ROLLOVER PROBLEMS

MR. CARTER: The program lists the next item for discussion as "Rollover Problems"; I would prefer "Rollover Possibilities" or "Rollover Opportunities." As the IRA becomes an established tax shelter for the individual over the next few years, the rollover market will become a very large and attractive one.

It will pose a problem only for those companies whose regular IRA product does not stand up competitively.

The rollover market will come from several sources and can only grow for some time as experience under ERISA and subsequent pension legislation becomes established. The sources for rollover will only be mentioned for a point of reference since everyone here is probably well aware of them:

1. Lump-sum distributions from qualified plans upon termination, death, or attaining age $59\frac{1}{2}$;

2. Lump-sum distributions resulting from plan termination or cessation of employer contributions; and

3. Rollover from one IRA to another, allowed once every three years.

For the company with a less-than-competitive regular IRA product, the third item will be the biggest problem. Once the IRA contract-holder realizes the attractiveness of sheltering income in his IRA, he will become concerned about its competitive attractiveness. If his product does not measure up well against the competition, he will roll it over to another product every three years until he finds one that he is satisfied with. For the company that issued him the original IRA, the rollover represents a lapse. Thus the problem for the noncompetitive company becomes one of lapses.

Any company that does not develop a competitive product aimed directly at the rollover market has a problem of its own, at least if it has any interest at all in the IRA area. Its problem is that it may very well be depriving its field force of a very lucrative market for additional income. Lump-sum distributions from the first two sources may very well represent sizable sums of money. With the recent addition of rollovers from plan terminations, an agent with a highly competitive product stands to gain a significant total commission if he is aware of a prospective plan termination and if he can get to a large proportion of the participants early enough in the plan termination process. For an individual terminating his service, if he is highly paid or has a substantial accrued benefit, the size of his distribution may be very large. In any case, the selling job on the advisability of a rollover IRA should be easy. The major task will become selling the prospect on the attractiveness of the agent's particular product.

If the agent has a competitive regular IRA product to go with his rollover product, he is well armed to go out seeking rollovers from the third source, whether the IRA to be rolled over is with a bank, a savings and loan, or another insurance company. In addition, if his regular product is highly competitive, he does not need to worry so much about his existing business being rolled over by someone else.

As I see the rollover product which will evolve, it is not very different from the traditional single premium deferred annuity. It will be similar to the following:

1. It will have a low load;

2. Its guaranteed cash values will be as high as state nonforfeiture laws will allow and as the company's surplus position will stand;

3. Excess interest payments will be as high as can be justified and will be very competitive with both other life companies and banks and savings and loans;

4. The commission rate will be consistent with the load - probably in the 2% to 5% range; and

5. The settlement option rate will be especially attractive.

The last item mentioned, settlement option rates, may well become a key for the agent, especially in attempting to attract rollovers away from bank IRA's. If the agent can approach a bank IRA customer who is between 50 and 55 and show him the attractive income available to him in the next ten years or so as a result of the settlement option rate and in spite of the initial load on the rollover, he may find a ready-made market in the next few years.

It is for these reasons that I believe the rollover area offers more possibilities and opportunities than problems.

MR. WIEBKE: I'd like to add just a few words concerning the role of immediate annuities, because I think it is an important role. There are numerous profit-sharing plans today that provide only for a lump-sum distribution at retirement and,unless the onerous burdens of ERISA'S "Qualified Joint and Survivor" are indicated to be not applicable where the normal settlement is single sum, there will be many more profit-sharing plans providing only for lump-sum distributions. These lump-sum distributions can be rolled over to immediate annuity IRA's. Futhermore, it should be noted that the regular IRA "lost" to a bank is a prime immediate annuity IRA rollover candidate at retirement.

There are some potential problems which could result from lack of thorough understanding of the requirements for an IRA rollover to be available. The amount applied must be the total lump-sum distribution (except for employee contributions) and,except in the case of plan termination, the participant must have been a participant for five years before the lump-sum distribution is made; the purchase of the IRA must be made within 60 days of receipt of the lump-sum distribution; etc. It is relatively easy to undo an improper purchase of a deferred annuity IRA rollover (i.e. where one or more of the required conditions were not met), whereas it is never easy nor always possible to undo an immediate annuity.

PROBLEMS WITH INCREASES

MR. SMITH: Not that there are no problems with decreases in the amount level of considerations going into an IRA, we shall, however, for the few minutes we have, discuss the factors connected with increases in the amount level of contributions going into an IRA. Let's confine our thoughts to the following:

1. Pricing
2. Statutory consideration
3. IRS regulations

Sooner or later a philosophical, if not practical, position must be taken in regard to the question of producer compensation in connection with increased contributions. It is a common, but certainly not universal, practice for life insurers to consider, under certain renewable term coverages, as well as certain noncancellable and guaranteed renewable accident and health coverages, to pay additional compensation upon the excess portion of the increased premiums.

The matter of doing so with flexible premium annuities should be linked with the level of loading income. Those contracts providing level loading deductions would basically be in no worse position than if a new contract had been issued. Those contracts providing nonlevel loading deductions and no contractual provisions for deductions of the higher initial loading, must negotiate compromise. It is highly unlikely that the proportion of producer compensation on increases as in the initial year would permit the attainment of desired surplus contributions and yet the producer may find only renewal compensation as far from satisfactory.

One approach in these situations would be the determination of producer compensation possible had the contract employed level loading deductions and the same compensation as on renewals. In practice, the determination of an increase accruing would not be made until the occurrence of either the contract anniversary or at the point at which the contributions first exceed the assumed level of annual contributions. Recognition ought to be given to any previous deficiencies occurring as well.

Not divorced from considerations in these matters are statutory considerations. Contracts providing for larger loading deductions in the event of increases must do so within compliance of the various states' minimum value requirements for annuity contracts. There is hardly any consistency within these requirements both as to approach for determination of minimum values and recognition of increased contributions.

As excess contributions, as opposed to increased contributions, are subject to excise taxes, the issuer of an IRA, particularly those contracts providing level deductions, can face those public relations problems associated with having to return those excess contributions and earnings thereon in a lesser amount than contributed.

No clear guidelines exist as to the proper handling of the associated problems when contributions are received and considered as paid for tax purposes and the completion of Form 5498. It would be highly undesirable for increased contributions to result in excess contributions simply as a matter of record keeping. It is hoped that guidelines will be issued soon as to the proper determination of contributions paid for tax purposes.

MR. CARTER: In paying increased commissions on increased premiums, the problem of my former company was in trying to decide if the increase is permanent and thus increased commissions should be paid. If it is a one-shot increase, it is inequitable if you have heaped commissions of a flexible annuity charged against what is really a single premium. Chargeback procedures may be needed to compensate if it is a temporary increase. As a result, we may see more of a trend to level commissions and level loads as in Canada with the RRSP.

MR. SHELL: The commission scale on most flexible premium annuities used to fund RRSP's is either a higher rate on the first $x of accumulated premiums and a flat rate thereafter, or a flat rate throughout. Therefore, in general, problems associated with commissions on increases do not arise.

COMPETITION FROM OTHER INSTITUTIONS

MR. WIEBKE: In commenting on successful products, I have already indicated my view that banks are not as serious competitors as might be inferred from their competitive sounding advertisements, simply because they do not have the delivery system. Similarly, and more so because there is really no advertising, the government bonds for IRA purposes are not effective competition. Presently, mutual funds are still seeking to strike the public's fancy once again, and they are not much of a competitive force in the meantime.

It should be noted that banks have been refining their product to make it more attractive. Perhaps most significantly, they are able to offer the time deposit accounts, without the customary minimum deposit requirements, in IRA situations.

As previously mentioned, insurance companies will be responding to their own competition as well as that from other institutions, through product improvement. In any event, unique aspects of the insurance company products provide means for overcoming other institutions' competition. In particular, I refer to insurance, guaranteed annuity pay-out, and the disability waiver of premium provision. In many situations, these can be extremely important. Some companies, in fact, have concluded that even an annuity contract is not a different enough product from the bank product to avoid the natural, but incomplete, comparison based solely on cash value results, and, as a result, have concentrated on marketing retirement income or endowment policies.

MR. SHELL: In Canada, insurance companies, trust companies, banks and mutual funds are the major competitors for RRSP dollars.

When the RRSP concept was introduced, the major emphasis was on the provision of retirement income. Insurance companies captured the lion's share of the market through the use of their conventional retirement annuity products.

By the early 1970's, banks and trust companies were giving increasing attention to this source of business. When the RRSP deductible limits were increased in 1972, competition began in earnest. With the rise in interest rates, the RRSP came to be seen as an investment. As trust companies do not have vehicles for long-term guaranteed growth and as they are not licensed to sell annuities, they encouraged the concept of RRSP as an investment. As there is no restriction on the frequency of RRSP rollovers, they came to be seen as short-term investments, with the option of transferring to another carrier if performance was not satisfactory. Of course, the traditional insurance company products with front-end loads, relatively high commissions, and low early cash values could not compete in this type of market.

As described earlier, the insurance industry realigned its marketing effort towards flexible premium, low-load products to compete with the trust companies. The trust companies now emphasize in their competitive efforts the facts that they pay no commission and that they, in general, have no load (that is, expenses are normally recovered through a management fee of about .75%). Insurance company products normally have an expense load which is visible at the front end. Insurance companies, on the other hand, emphasize that RRSP's are very complex and should be purchased only on the basis of expert advice. This advice is paid for in the form of modest commissions. They also try to re-emphasize the RRSP as a vehicle for retirement savings rather than a short-term investment device. The insurance industry tries to focus on long-term results while the trust companies try to emphasize short-term results.

The approximate results for the 1974 new registrations by number of registrations were:

Life Insurance Companies and Fraternal Societies	40%
Trust Companies	33%
Bank, Mutual Funds, and All Other	27%

APPLICABILITY OF NEW MONEY RATES

MR. JACKSON: The competition between banks and insurance companies in the IRA marketplace is a source of intense pressure on, and demand for, insurance companies to provide products that can hold their own in competition with the high interest rates illustrated and advertised by banks.

The historical participating individual deferred annuity product was based on net premiums accumulated at a low guaranteed interest and with dividends based on portfolio earnings. When a non-par product was used, it had slightly higher guaranteed interest. Neither product, generally, could compete with current high interest rates offered by the banks. Many mutual companies have moved in the direction of developing annuity dividend classes featuring current investment results for current issues. Stock companies are using a product which has a guaranteed rate, and are crediting or paying additional interest related to current investment results. Either of these products may provide for interest guarantees close to current results for a limited period such as the first five years.

There is no unanimity of actuarial opinion as to whether or how you can maintain equity among classes of contract-holders under either approach, and those of you who attended Concurrent Session A* yesterday were exposed to philosophy and practice in some depth. Certainly, more and more companies are finding ways to introduce investment year concepts into their individual deferred annuity contracts.

Whether competitive interest is provided by guaranteed high rates or by some "new money" device, investment antiselection through surrender or withdrawal is a problem which must be solved by both banks and insurance companies. Banks must apply penalties for early withdrawal on C.D. type accounts. Insurance companies are partially protected by a front-end load but have not generally applied early surrender charges, except to group annuities. Further protection is needed by the insurance companies, in the form of some type of penalty for premature withdrawal.

MR. SHELL: In general, an RRSP product which does not reflect current market rates and is not a segregated fund is not saleable. The new money rates are reflected in several ways.

To protect against surrender, companies use a flat charge to cover an average investment loss or use a yield lag to compensate. Neither is usually very scientifically determined.

LONG-TERM INTEREST GUARANTEES

MR. SMITH: One of the primary requirements for an IRA to be competitive with other IRAs, but unfortunately often the first and only criteria used, is the interest-credited rate. Our own company's experience, resulting from extensive field force surveys, was to place heavy emphasis on the guaranteed interest rate in the design of a flexible premium annuity because the field thought the competition from other financial institutions could be combatted effectively if the insurance industry would provide attractive guarantees.

For those who may not be familiar with our company's product, our Flexible Premium Retirement Annuity guarantees interest credits at the rate of 5% during the first ten years and 4% thereafter. We have been recognized for

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these pioneering efforts somewhat in a recent consumer's publication. It was our feeling that guarantees along the order of current regular savings account rates would be satisfactory in that regard. However, it was not foremost in our minds that the additional reserve requirements for interest rates in excess of maximum valuation rates for annuity contracts would become as popular as they have become nor did we anticipate the rather tardy adoption of the NAIC amendments to the Standard Valuation Law, permitting a valuation rate of 4%, by such a number of states. In short, our adoption of such guarantees was made largely under the assumption that "it wouldn't cost us anything."

These additional reserve requirements have been referred to as deficiency reserves in the sense that the company should set aside additional funds to provide for contingency of the guarantee being deficient with the then current yields during the guaranteed period. Contrary to premium deficiency reserves, which most non-participating companies commonly face, the additional reserves do not peak out initially but, in fact, increase for a period of several years thus creating severe surplus strain concerns for the lesser financial stalwarts. Under present conditions, our own company is well able to weather such requirements and we endorse the intent of the regulators in this regard.

As I understand it, there is another approach in regard to the additional reserves which purports that the required additional reserves are not necessary if the valuation method employed for such contracts would result in statutory amounts as great as or greater than the total of the permissible minimum reserve and these additional reserves.

There is a concern among regulators that the financial investment laws and regulations for life insurance companies do not contemplate and do not provide the safeguards to conduct business which is of the demand-deposit type variety. Similar to the thoughts expressed earlier by Mr. Jackson, perhaps these protections can be provided more effectively through premature withdrawal penalties as opposed to burdensome additional reserves. It should be noted, of course, that the IRS regulations do prescribe excess tax penalties for withdrawals prior to age $59\frac{1}{2}$.

MR. SHELL: Long-term interest guarantees are not very important in the RRSP field. The average guarantee in the insurance industry is about 5 years and relates to simple interest credited on specific deposits. Most insurance company products do have a long-term interest guarantee but it is normally at a very low level and is not an item of competition.

In trust company products, there is typically a guarantee of the interest a fund will earn for about six months or a guarantee of the simple interest applicable to a specific deposit for about 5 years.