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DEBATE, "RESOLVED . . . THE LIFE INSURANCE BUSINESS, AS TRANSACTED TODAY, IS IN ITS TERMINAL STAGES."

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MR. JAMES C. H. ANDERSON: Eighteen months ago, I presented a paper to the Seventh Pacific Insurance Conference with the innocuous title The Universal Life Insurance Policy. Because the title of the paper antedated its writing by several months, it did not adequately describe the content. In fact, the paper could more appropriately have been titled A Critique of Traditional Life Insurance Products and Distribution Systems, a title which I have since used in subsequent discussions of the paper before various actuarial clubs and life insurance industry groups. The following excerpt summarizes the main arguments advanced:

". . . that it is no longer realistic to assume that the typical life insurance buyer is one who will, for an extended period of time, remain married to the same wife, work at the same job and live in the same house situated in the same city; or that the financial security needs of this typical buyer and his ability to pay for them will remain constant and can be expressed in constant nominal dollars.

". . . that it is not realistic for the industry to address the needs of the typical buyer with traditional permanent life insurance products requiring fixed regular premiums and providing fixed benefits, both expressed in constant nominal dollars.

". . . that the traditional life insurance industry distribution and administrative systems are excessively and unnecessarily costly and place the industry at a competitive disadvantage by comparison with other savings media.

". . . that the industry should respond to the needs of the contemporary market by introducing a simplified, flexible and less costly product.

". . . that the introduction of such a product is technically and financially feasible if a more effective distribution system can concurrently be developed.

". . . that the introduction of such a product would probably have a serious and adverse initial impact on the life insurance industry and its existing distribution systems.

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". . . that, notwithstanding the foreseen difficulties, the needs and demands of the market will lead to the introduction of such a product, possibly led by companies with no commitment to traditional distribution systems, and that the eventual result will be more favorable to the life insurance industry than the only realistic alternative - an all term industry.

"Obviously, these are sweeping arguments and they imply nothing less than a coming revolution with the life insurance industry. The limited scope of this paper does not permit their full development, nor does it permit adequate consideration of counter-arguments."

The life insurance industry is not a homogeneous business. In fact, a broad interpretation of the subject of this debate would require a separate examination of the number of sub-businesses. I intend, however, to concentrate my attention on the individual ordinary life insurance business, which still represents the backbone of the industry, and to examine the health of this sector of the industry by addressing the following five questions: (1) Does the industry really understand the contemporary environment for individual financial security products? (2) Are traditional life insurance products, notably permanent insurance, appropriate to the needs of the typical buyer under today's market conditions? (3) Are traditional life insurance products economically viable from the viewpoint of either the buyer or the industry? (4) Is the industry seriously vulnerable to a concerted raid on its accumulated assets mounted either from within the industry or from outside it? (5) Why are the shares of many publicly quoted life insurance companies selling at discounts of 50% or more from their underlying values?

Does the industry really understand the contemporary environment for individual financial security products?

I submit that the marketing strategy of the life insurance industry taken as a whole still rests, to an important extent, on the implicit assumption that the average American family consists of a breadwinner husband, a homemaker wife and (on average) two dependent children. Is this perception even approximately true today?

The following article which appears last year in the Atlanta Constitution suggests that that is not the case:

"BOTH HUSBAND, WIFE IN TYPICAL FAMILY WORK

WASHINGTON (UPI) - Both husband and wife in today's "typical" American family have outside jobs, partly because of inflation's impact on income, according to the Labor department.

The historic image of a breadwinner husband and homemaker wife now applies to only 34 out of 100 marriages, it said in the current issue of the Monthly Labor Review."

More recently, in a Labor Department release dated March 8, 1977, there appears the following startling (and also misleading) statement which was reported on national television a few weeks ago: "The concept of a family where the husband is the only breadwinner, the wife is a homemaker. . ., and there are two children may be a useful one for many illustrative purposes, but it does not represent the typical American family of the mid-1970's. Among husband-wife families in 1975, only seven out of 100 fit this description."

Although the foregoing quotation is faithful to the Labor Department release, the excerpt is misleading when the facts included in the tables which accompanied the release are examined closely. There are approximately 47 million husband-wife families in the United States of which only 14 million are families where the husband is the only earner - five million families have no earners - two million have one earner other than the husband - 20 million have two earners - and seven million have three or more earners. Of those 14 million families where the husband is the only earner, nine million such families consist of three or more persons and it will be these nine million families, 19% of all of the husband-wife families, who would fit the classical pattern. Although these facts are startling enough, bear in mind that husband-wife families account for only two-thirds of the adult population of the country.

Other fundamental changes in the market environment are, for this audience self-evident and I will only enumerate them.

(1) Government is rapidly becoming the principal purveyor of financial security products - I estimate that the life insurance in force of the Social Security system alone is at least two trillion dollars, roughly equal to the life insurance in force of all types in the United States.

(2) Most people believe that we are in an era where we may expect, for an extended period of time, higher rates of inflation than we are accustomed to; inflation must undermine the value of all long term promises, particularly money promises such as life insurance policies provide.

To what extent can the industry reasonably claim that it has modified its products, its delivery systems and its own economics in response to these changed circumstances? Moreover, the work of professional futurists suggests that the changes in store for us in the immediate future are far more radical than those which I believe are already shaking the foundations of this industry. Those with an interest in futurism, and that should include us all, might profit from a reading or a rereading of the more respected works in this field. For those who prefer a course of condensed reading, there is an excellent summary included in John M. Bragg's Landmark paper, The Future of the Actuarial Profession as Viewed in A.D. 1974," which appears in TSA XXVI.

Are traditional life insurance products, notably permanent insurance, appropriate to the needs of the typical buyer under today's market conditions?

Overwhelmingly, the majority of financial security products sold to individuals by the life insurance industry are characterized by the requirement of regular premiums on a fixed dollar amount and provide benefits also of a

fixed dollar amount; most of the premium income of the industry and the commission income of its distribution systems arising from current sales relate to permanent, cash value forms of life insurance.

Are these the products appropriate to the needs of the typical buyer under today's market conditions? Consider the case of a 25 year old buyer with a young family and a current annual income of $10,000. With an annual productivity gain of 2% and no inflation, he might expect an equivalent income at age 55 of $18,000. If, however, inflation is assumed to continue throughout the 30 year period at a rate of only 5%, his nominal annual income at age 55 would be $78,000. If this buyer purchased a $10,000 policy at age 25, its value in constant dollars would be only $2,300, 30 years later. I do not believe that fixed premium, fixed benefit, permanent, cash value life insurance has any relevance to this potential buyer's financial requirements over 30 years, considering only the consequences of inflation. I believe that most actuaries would agree that the assumptions underlying the illustration are quite modest and that even more radical changes in the financial circumstances of such an individual are more likely to occur than not.

But this is not the whole story, or even half of it. Our potential buyer is far more likely than not to undergo non-financial changes that will have an even more major impact on his financial requirements over 30 years. Since our format this morning is that of a debate, consider the following proposition: Resolved, that the expected number of wives of a 20 year old unmarried male exceeds his expected number of children. Would you rather argue the affirmative or the negative case for this proposition?

Are traditional life insurance products economically viable from the viewpoint of either the buyer or the industry?

In the interest of determining the profile of a typical premium rate for permanent, cash value life insurance, I have made some calculations dealing with a nonparticipating and a participating ordinary life policy issued at age 35. The calculations were based on what I believe to be optimistic but representative sets of assumptions, comparable to those I have observed being used by well managed medium and large companies. After calculating a standard premium rate for both the nonparticipating and participating forms, I successively reduced each of the various assumptions to zero with all other assumptions held constant and calculated premium rates to determine how much of the premium was attributable to each of the assumptions. The results indicated that the amount of the standard premium required to meet expenses was quite high - 41% of the total for the nonparticipating form and 30% for the participating form. (This difference, incidentally, relates not to differences in the assumed level of expenses but to differences in the cost of capital required to finance new business by the shareholder-owned and policyholder-owned companies.) The cost of lapses was 8% for the nonparticipating and 4% for the participating form. The cost of death benefits was 10% of the total for the nonparticipating form and 14% for the participating form. Profits represented 5% for the nonparticipating form and surplus contributions 2% for the participating form. Cash value accumulations and policyholder dividends accounted for 36% of the nonparticipating premium and 50% of the participating premium.

Is it fair and reasonable that a nonparticipating policyholder should have 41% of his premium consumed by expenses, 8% by premature lapses and 5% by shareholder profits - a total of 54%? Is it fair and reasonable that a

participating policyholder should have 30% of this premium consumed by expenses, 4% by premature lapses and 2% by surplus contributions - a total of 36%? I would reiterate that the differences in the profiles of the nonparticipating and participating premium rates are attributable to differences in the cost of capital required to finance new business and not to differences in expense levels.

It is often argued that an ordinary life insurance policy must be viewed in its entirety as a contract providing protection against premature death. But are we really selling premature death benefit coverage when only 10% of the premium is required to provide the mortality cost for the nonparticipating policy and only 14% for the participating policy? In short, is this a viable product from the viewpoint of the consumer and will the consumer continue to accept these cost levels, particularly when competing savings products are available at substantial lower cost levels which can be supported by term insurance products that the industry is prepared to offer quite cheaply?

Socrates admonished us that the first step in knowing the truth is to call a thing by its right name. I am suggesting that the buyer of our wares, given the facts, would not choose a flattering name for either of these products.

It is also instructive to compare the relative competitive position of these representative premium rates with prices available in the market place. A comparison with nonparticipating products offered by 18 medium to large sized companies indicates that their average traditional net cost is $2.20 per thousand lower than the representative calculation, 12% of premium; the interest adjusted cost is $1.66 per thousand lower, 9% of premium. A similar comparison of the participating product shows a traditional net cost $1.93 per thousand less than that of the representative product, 9% of premium; the average interest adjusted cost is $.49 per thousand less, 2% of premium. These results suggest either:

(1) That the representative assumptions are not representative, a possibility which I reject, or

(2) That a large and important segment of the industry is using a pricing basis which is probably not economically sound.

How many companies represented here have examined separately the profitability of their existing business in force and that of their future new business? Would it surprise you to discover that <u>more than all</u> of your future profits will be derived from existing business and that future business, viewed separately, might project perpetual losses if an adequate return on the capital invested in new business is factored into the calculations? Can you imagine what the projection would look like if future new business were further subdivided into that which will be produced by your existing agents and that which will be produced by agents you have not yet hired? Since approximately two-thirds of the expenses of a typical life insurance company are associated with the distribution system, it follows that a critical examination of expense levels quickly focuses on this area of operation. In this connection, it is worth noting that the average sales frequency of the industry is very low - approximately one sale per week per full time equivalent agent.

In that one sad statistic may lie the root of the whole problem. Is it reasonable to pay an agent a full time income for making just one sale a week? Is our product so difficult to sell that 40 hours of effort are required to effect just one sale? Is it not possible that a more attractively priced product could be sold twice as easily and that the present distribution system might effect twice as many sales with a 50% reduction in unit distribution costs?

Ours is an industry particularly susceptible to its own cant, in my view. I have heard my friend and associate, Tom Bowles, refer to our "velvet rut."

Let's start with "Life insurance has to be sold." The Insurance Institute of London Report of the Advance Study Group (No. 27) includes the following quotation from the records of one United Kingdom company: "The Committee having considered Proper Measures for enlarging the Insurance of this Office, have thought convenient to Appoint Persons of Reputation and substance in the Chief Towns and Cities to Distribute Policies and receive all Quarterages and to allow such persons One Shilling in the Pound as an Equivalent for their Trouble."

That statement reasonably describes the marketing strategy still being followed by companies distributing their wares through personal producing general agents. Yet it was recorded in December 1720 - 257 years ago! Is it possible that such a marketing strategy could still be the best available today when a typical Sunday press run of the New York Times far surpasses the entire printed word as it existed in 1720? When commercial radio is well into its second half century? When commercial television has been generally available for approximately 30 years? And when a computer terminal no costlier nor less portable than a 1960 desk top calculator can access powerful computers over an ordinary telephone line?

I am reminded of a conversation I had a few years ago with a representative of Coutts Bank, a venerable if somewhat old fashioned financial institution, where striped pants and frock coats are still very much in vogue. He said to me, "Mr. Anderson, it would be a mistake for you to think of us as a 19th century institution - we are an 18th century institution." Is it possible that this observation has some relevance to our own venerable distribution system?

It's also instructive to observe the recent growth of savings bank life insurance, particularly in New York. From 1970 to 1975, life insurance in force increased at a compound rate of 14% per annum and sales increased at a compound rate of 17% per annum; both rates substantially surpassed those of the life insurance industry.

Another long accepted truism of our industry is this: Our agency organizations are our most valuable assets. Is this really true? Or do we mean that our agency organizations are our most costly assets? Based on the experience of several highly respected companies to which I have been made privy, I know that the cost of "manufacturing" from scratch a full time established agent is in the vicinity of $100,000. I judge this figure to be right, at least to the nearest $100,000! If the company developing that agent is to recover its costs, together with a reasonable rate of return on its costs, the required productivity of the agent is absurdly high - which is another way of saying that it is no longer economically viable to develop new agents on the basis of current experience.

In summary, it is my contention that we are distributing a product which is economically unattractive to the buyer and economically unsound from the industry viewpoint. This unsatisfactory state of affairs is attributable, in my view, to unreasonably high expenses, notably distribution costs, to an unfavorable Federal income tax position and to high termination rates. To make matters worse, it is my judgment that the trends in each of these areas suggest a worsening position - most companies are experiencing increasing expense rates, the Federal income tax burden of the industry as a whole is increasing disapportionately year by year, and the Life Insurance Fact Book shows clearly a 25 year trend of increasing lapses (from 1951 to 1975 voluntary termination rates on new policies, on old policies and on both groups combined have increased by more than 100%).

Is the industry seriously vulnerable to a concerted raid on its accumulated assets mounted either from within the industry or from outside it?

I believe that the spectre of large scale replacement of existing business in force is no illusion. Whether this takes the form of an outright raid on accumulated cash values or a systematic exploitation of policy loan provisions, the result would be the same. The industry, as a whole, is holding fixed income securities on which there is a substantial market depreciation but its outstanding policy contracts contain guaranteed cash values and guaranteed policy loan facilities which afford the industry no protection from market depreciation. In these circumstances, the danger of a raid is real and some might even argue that the raid is already in progress and has been for a number of years.

Why are the shares of many publicly quoted life insurance companies selling at discounts of 50% or more from their underlying values?

Those who have been involved in the business of evaluating life insurance companies for purchase, sale, merger or other purpose will agree, I believe, with the discount cited. In fact, some whole companies have recently sold at substantial premiums over their quoted market values. What does this signal?

I believe that it signals that the investment community is conscious of some of the industry problems which I have discussed in this presentation. In particular, I believe that investors are dissatisfied with the return on capital. It also means that many companies are worth more dead than alive, a phrase for which I am indebted to Mel Gold. The implications for stock life insurance companies are quite disturbing: particularly for overcapitalized stock life insurance companies, there exists the opportunity for a non-financial company in another industry to purchase the life insurance company at a discount and redeploy its capital funds elsewhere. The public interest may also be involved if a substantial portion of the industry should fall into the hands of non-financial companies with different attitudes towards acceptable levels of risk and responsibility as well as profits.

Other lines of business

I've concentrated in this presentation on the individual ordinary life insurance business. It is appropriate, in addition, to note that all is not necessarily well in other lines of business which make up the industry.

The home service branch of the industry suffers from even more unsatisfactory benefit to cost ratios than the ordinary branch. Surely it must be recognized that this line of business is vulnerable to the attention of politicians and consumerists alike.

Both the individual and group health insurance lines of business have experienced an extended period of unsatisfactory financial results and a major proportion of these lines of business is vulnerable to a national health insurance program.

Credit insurance is a line of business which is also vulnerable to state regulatory intervention.

Summary

In summary, I see an industry in a state of actual or impending crisis. But to address more directly the subject of this debate and to present a more believable argument that fundamental change is imminent, it is necessary for me to suggest who will administer the coup-de-grace to some of our more cherished practices and how it will be administered. In this context, I would suggest that you bear in mind that while civil libertarians, courts and juries may be reluctant to administer capital punishment on an individual basis, I detect no comparable squeamishness on the part of creditors of corporations.

My preferred scenario is that the industry itself - hopefully, lead by the actuarial profession - will recognize its own problems and shortcomings and initiate changes from within. Are we as actuaries living up to our professional responsibilities if we do not communicate forcefully our concerns for the future of the industry - both for the companies which comprise it and for the policyholders it serves? If change is to come in this way, I would predict that it would take the form of a radical change in our products, our price structure and our distribution systems. It is worth noting that precisely such changes in products, price structure and distribution systems have, in the past, lead to major rearrangements of industry market shares.

If change is to be imposed upon the industry from outside, it might take any of several forms. Massive intervention by government, either by the imposition of wide-ranging regulations or by a further takeover of many of the industry's functions, might be considered as the "Big Bang" alternative which leaves behind only a pile of rubble to be picked over; to some extent this is what happened to the mutual fund industry's retail operations some years ago. An aggressive program mounted by renegade companies or by competitors from other savings media, perhaps supported by consumerists, leading to a concerted raid on asset accumulations might be described as the "Götterdämmerung" alternative. These are but two among many such possibilities.

Failing all else, it's my view that the industry will experience a gradual and painful self destruction caused by a "Doomsday" machine which has already been manufactured and has been running for several years. The "Doomsday" machine is our own cheap term insurance products which we freely make available to all who wish to construct their own insurance

cum investment program. The present economics of our business requires that the industry maintain a substantial stake in the savings market. Since we have a product monopoly on life insurance products, it is a mistake for us to make that product freely available at very low prices to those who wish to channel their savings into other media.

Conclusion

When I began to write and speak about these problems some 18 months ago, I expected to encounter a considerable amount of Maginot Line thinking from actuaries and other persons involved in the life insurance industry. Some, I imagine, would at least want my buttons, my epaulets and my sword (if not my head) for articulating such heresy. To my surprise, the reaction has been quite mild and significantly more sympathetic than I expected. This persuades me that the industry itself is already conscious of the problems which I have discussed in this presentation. Let me express the hope that it also signals a readiness to contemplate revolutionary change and that my preferred future may become a reality.

MR. E. J. MOORHEAD: Mr. Anderson is confusing terminal illness with the normal trials and tribulations that are good for us. I disagree that the business now being issued will not pay its way because the reverse can be demonstrated simply by the proposition that actuaries are conservative and what they are doing is conservative and what they are doing is going to turn out all right in the long run for everybody except the policyholders.

Years ago, when I worked for what was then the Life Insurance Agency Management Association, we used to teach in the Agency Management School the belief that just so long as men loved their wives and children, just that long will life insurance endure. I have since changed my view on that. I now say just so long as presumably well-educated people thoughtfully accept the typical explanation of why life insurance gives you good value for the dollar, just so long will life insurance endure, and that is a long time. We do not yet have a public that has reached the highly tuned state of spending aversion to life insurance that Mr. Anderson has portrayed.

The major parts of our differences are in identifying the problems that do exist and considering the time that is available to do something about them. Whole life insurance as it is provided today by the most efficient of the life insurance companies does justify buyer acceptance and will continue to do the job fairly well. The problem is that the spectrum of prices and to some degree the spectrum of quality of those products is broader than is desirable in an era of greater consumer enlightment. The problem is not that there are not products on the market that justify the trust and use of the buying public. The answer therefore is not to sweep away what we have today and replace it by something else, although innovations that supplement the basic life insurance policies are very much to be desired and are in fact taking place. We must demonstrate to those who are looking at us that competition with its desirable features as envisaged two centuries ago by Adam Smith does exist and does cause life insurance companies in their own self interest to provide products that are as close as possible to matching the best that are available in the market today.

The following shortcomings urgently need your attention. First, we must consider whether whole life insurance on the nonparticipating system is really feasible in the volatile economic, demographic, and social conditions that exist today. The actuary calculating a nonparticipating premium is faced with a more painful dilemma than has ever been the case in the actuarial profession before. He is in the position of believing one thing and making his calculations on a different set of assumptions. He believes in general that interest rates will stay up; he makes his calculations on the assumption that interest rates will remain at present levels during the time when the reserve is so small that it does not make any difference what assumption he uses, and that they will decline at the time when the value of the policy increases to the point when the interest element is significant. The answer is the abandonment of nonparticipating insurance except on low investment element short term policies.

Second, urgent attention must be devoted to active promotion by actuaries of more enlightened policy approval systems in the state insurance departments. At the present time, policies are being designed for the purpose of either quoting or evading easy comparison with other policies. That is not a problem, as some believe, which can be solved by laying vast numbers of figures in front of the consumer but is a problem which must be faced at the regulatory level. It will have to be faced by the formation in the insurance departments of central offices adequately staffed with people who understand this subject and who are prepared to go to battle on the question of whether a particular pattern of cash values and endowment benefits and dividends does serve the interest of the public or whether it is there for a less appropriate purpose.

Finally, both company actuaries and, of more importance, consulting actuaries need to approach the matter of calculation of premiums, cash values and dividends from a different angle than has been traditional in the business these many years. The procedure is to make the calculation on the assumptions that seem to fit the operating factors in the company and then take a look to see whether they are competitive. It will be more and more necessary as buyer enlightenment increases and as pressures for regulation become stronger that actuaries tackle the competitive questions first, and then instruct and work with the management of their company to see whether they can live within those competitive factors. We are doing the whole job backwards. If you feel that this set of processes to which I have referred is a good set of processes, and if you feel that you have a choice between doing some of these things now or eventually, my only warning is that eventually may not be soon enough.

MR. ANDERSON: Another long accepted truism of our industry is that . . . "our agency organizations are our most valuable assets." Is this really true? Perhaps we mean our agency organizations are our most costly assets. The cost of manufacturing from scratch an established agent is in the vicinity of $100,000. This figure I would judge to be right to the nearest $100,000. If the company developing that agent is to recover its cost together with a reasonable rate of return on its costs, the required productivity of the agent is absurdly high - which is another way of saying that it is no longer economically viable to develop new agents on the basis of current experience. Is that a viable ongoing operation? The reason why the equivalent level expense turns out to be 41% for nonparticipating and 30% for participating may be puzzling. The difference between those two figures is really the difference between the fact that policyholders traditionally receive rates of return preferable

to that which can be earned on bonds and stocks and then discounted for tax; let's say 6%. Shareholders need to have a return of approximately 15% on the investment in the life insurance company in order to be competitive with other investments, so the 11% difference is largely attributable to required rates of return on the use of the shareholders capital. Mr. Moorhead has suggested a new procedure for establishing premium rates and at first I was not sure whether he was going to suggest that we raise them to cover what our expenses actually are or lower them down to where our expenses should actually be. I am sympathetic with the latter point of view.

DR. DAVIS W. GREGG: There is a lack of passion in what has been expressed and if the actuary can prove that he is passionate in his beliefs, I would feel better. The proposition that has been debated is that individual life insurance as transacted today is in its terminal stages. We should put this in a proper framework as to whether we are talking about the more limited area of individual life insurance or the broader area of the life insurance industry.

MR. ARDIAN C. GILL: Mr. Moorhead first called upon the requirement of love to sustain the industry and then said, "No, he rejects that." It depends on the gullibility of the public. An agent of my company once explained that to me in a slightly different way. He said the three sweetest words in the English language are not "I love you," but "check is enclosed."

Mr. Moorhead, I understand you to say that you want to mutualize the stock companies, or at least the whole life product and raise the price of term. Whatever happened to the market place forces and the forces of free enterprise? Are we headed as one of Mr. Anderson's scenarios suggests, toward government as our saviour? Are we going to be like the airlines where we require regulation to keep us in business?

MR. MOORHEAD: The complexities of the life insurance business are too great for the market place forces to operate in the classic economic fashion. It is the public ignorance that is preventing market place forces from working as they should. I am not suggesting that there is no competition. I am suggesting that the spectrum of prices suggests that there is insufficient price competition. The competition tends to be rather muted and tends to be competition for agents rather than competition in the quality and pricing of our product. A great deal is said in the training of life insurance agents that give them a false and unduly rosy picture of the way in which life insurance functions. That was one of the reasons for the development of the interest adjusted method. We were working with a system that encouraged the belief that permanent life insurance doesn't cost anything, which is not the case.

MR. ANDERSON: We are behaving in the normal economic pattern if you make the one assumption that the client of the industry is the agent and not the policyholder. If you make that assumption, then the general behavior pattern becomes a lot closer to the classical one.

The industry's pattern of commission rates is substantially influenced by the New York legislation. What would the profile of a typical premium rate have looked like circa 1905? If the arithmetic has been done in more or less the way I demonstrated in my opening remarks, the mortality costs at that time would have represented a more substantial portion of the premium than it does today.

Perhaps the framers of the legislation that has governed our commission pattern for the last 70 years or so actually intended that the top commission rate should be paid on the longest form of term insurance. Around the beginning of this century, whole life insurance was really closer to term insurance than it was to anything else. The whole life products as a result of changes in mortality rates have drifted into the savings end of the spectrum. We have not adjusted our commissions accordingly.

DR. GREGG: The institution of life insurance serves basic human needs and wants for financial security. There is ample evidence that these needs and wants are increasing. People in our society are better able to pay for them. There is a second dimension that is essentially economic but it is totally broad. The institution of life insurance fills an increasingly significant role in an area. If the economic pie in our society is going to grow in a manner such that everyone can be better off, we have to have capital formation. The life insurance institution has a unique opportunity to make a continuing contribution in this particular way. This contribution should be understood by all. We have to build and renew our economic plant. Long term capital source is quite important.

We must examine marketing on the one-to-one basis in life insurance, warts and all, if it's going to be improved in the future. There is only one way that one can provide individual life insurance in the way that it should be provided to the American individual, family and business. There is only one way to do it, someone has to knock on the door and talk to people and persuade them to think about the future.

MR. ANDERSON: It is instructive to observe the recent growth of savings bank life insurance particularly in New York. From 1970 to 1975, life insurance in force increased at a compound rate of 14% per annum. Sales increased at a compound rate of 17% per annum. Both rates substantially surpassed those of the life insurance industry.

While life insurance still has to be sold, it does not necessarily have to be sold on the one-on-one basis leading up to what Dr. Gregg wants to describe as the critical encounter. We have a population today that is far better educated than any prior population that this country or any other country has ever had. Life insurance is not a novelty. It is something that people are familiar with. The process of selling life insurance 30 or 40 years ago was a very different process than it is today. There is hope for the use of the technology that has become available to us which has been ignored for the past 257 years. The agency system as we know it today, has a future, but its future lies in operating far more efficiently. It is madness that we have the equivalent of 500,000 life insurance agents in this country. The latest statistics suggest that there are 250,000 who get at least one-half of their income from life insurance and 250,000 who get less than one-half of their income from life insurance.

Assuming a 75%/25% mix, this works out to 250,000 full time equivalent agents. The distribution of our products does not require that much manpower. There was a time when we had thousands of elevator operators. What has happened to them? Technology has replaced people. It has replaced people in all industries.

MR. GILL: Mr. Gregg said the public is better able to pay for our product. It seems he is talking only about the upper and middle classes or about businesses. Is the industry now competing principally for the so-called sophisticated markets and ignoring the real mass market for individual life insurance in terms of numbers of people to be insured?

MR. MOORHEAD: There is a substantial argument that there is too much concentration on the affluent area of the business but that is understood by the marketing officers. They have to deal with it in two ways; first through their actuaries with the product that they offer and second, by trying to make sure that field people who can effectively handle the middle income market do not divert themselves by digging for gold in the affluent market and then eventually drop out of the business because that is not for them. The problem exists, but it is recognized and there is a good chance that it will be dealt with.

To the extent that the life insurance business does completely move away from a market, the government coverage will simply take over and life insurance business has that option. We can, if we wish, vacate more and let the government take over. It is not entirely a matter of whether the company would like to have that business. There is also a question of social responsibility. At what dividing point is it in the interest of the public that government coverage be the major provider, the "one-on-one" limited to a smaller part? The competitive element of trying to get bigger and bigger and bigger may interfere with the social responsibility element in that whole matter. It needs to be worked on.

DR. GREGG: If the expansionist group prevails in our society and the government schemes, whether Social Security, welfare, or whatever continue to expand, then we have examples around the world as to what will happen. Ninety percent of the American public is more fearful of big government than of big business. Therefore, the opportunity of the life insurance business in the financial security area is immense if we respond.

MR. MOORHEAD: The question is to what extent that attitude on the part of the public is fostered by a lack of understanding of just how life insurance works. Their eyes may be closed to some of the difficulties of the private enterprise side of this. That 90% may change as the public becomes more knowledgeable.

DR. GREGG: If the "Big Bang" is the enemy then a lot of things are going to change in this country beyond life insurance. The Götterdämmerung concept is a dangerous one. We saw what happened to private pensions when we turned our back on the field. The banks did quite well. The "Doomsday" scenario is the most risky element that Mr. Anderson has alerted us to, the concept that erosion is going to take place. Life insurance management has gone beyond the point where the opinion of the intellectual in the company is regarded to be of small import.

MR. GILL: A ratio of increase in policy loans to increase in premiums of three to one is respectable today. A ratio of increase in policy loans to increase in reserves of 30% or more is respectable. Is this not, in itself a raid on our assets? Are we not depending upon investment income for capital formation? Are we going to end up as flow-throughs to our policyholders and vitiate our role in the area of capital formation?

MR. ANDERSON: We are prisoners of our own statutory balance sheets and think that policy loans are assets. That is nonsense. Policy loans are not assets at all and have nothing to do with capital formation. It is just a peculiarity of the way that we keep books that makes us think that they are assets. If we were a normal kind of savings institution, they would be under the label of partial redemptions or partial withdrawals. If we look at our real results in terms of how we have managed to stay in the savings markets, those real results are a lot worse than the aggregate assets suggest.

The industry must stay in the savings business, otherwise its economics are going to be destroyed in a way worse than anything else we have discussed. That "Doomsday" scenario is the worst of all the scenarios. The only way we can stay in the savings market is to sharpen up our savings products and make them competitive with other savings products. Basing an industry of this size on public gullibility is a completely unsound premise.

MR. GILL: If each of you were to be appointed consultant to the entire life insurance industry, and recognizing that the essence of planning is to get the job done, what is the first step that you would recommend the industry take?

MR. ANDERSON: It would be an overhaul of the form of our permanent insurance products to make them more flexible and responsive accompanied by a radical overhaul of our field compensation system. Generally speaking, an overhaul would increase commission rates moderately to slightly on term insurance and reduce them radically on permanent forms.

MR. MOORHEAD: The first step the industry has to take is to recognize the things that we have debated. These are all controversial questions and we cannot deal with them as if we are sheep without a bellwether. There is bound to be a controversial element in anything that enlightens the public to these differences and gives them a more intelligent basis for choice than they have at the present time.

As long as we are committed institutionally to unity, we are unlikely to be able to take the first necessary step. It must be up to the heads and the actuaries of the companies which are providing products that do stand up well. It must be up to them to start to announce more steadily and more clearly that these differences do exist and that there is a reason for the public to turn to attractively priced types of products without fear of being shortchanged in quality or service.

DR. GREGG: The first step is to listen to what Mr. Anderson has said very carefully. Are we an insurance institution or are we something beyond an insurance institution as a financial security institution? What is our role in savings? This has been an ambivalence that has existed in this industry over several decades. It is a tragedy for the American public.

We must talk about life insurance as a savings institution in order to strengthen the quality of life in this nation in which we live. We can do things that others cannot do and we must be competitive and creative.