RECORD OF SOCIETY OF ACTUARIES
1978 VOL. 4 NO. 3

ADJUSTABLE LIFE PRODUCTS

Moderator: SAMUEL H. TURNER. Panelists: JOHN E. ASCHENBRENNER, GERALD R. CHAPMAN, ALICE M. NEENAN

MR. SAMUEL H. TURNER: "The wave of the future." "The ultimate in permanent life insurance." "The most consumer oriented product that the life insurance industry has ever offered." "(It) may become the dominant form of life insurance." "A major breakthrough." "The insurance-buying public .... may well be dissatisfied with anything less." "It ranks as one of the most significant insurance breakthroughs in 50 years." These, and other similar statements, have recently appeared in print in the Wall Street Journal, the ACLI's Council Review, the National Underwriter, Forbes, and other publications.

Upon what product have such lofty attributes been bestowed? Adjustable Life. Since such endearments have been predominantly, if not solely, voiced by proponents of Adjustable Life, one must question .... Is Adjustable Life the way of the future? Is it really the ultimate in permanent life insurance? Is it the most consumer-oriented product that the life insurance industry has ever offered? Will it become the dominant form of life insurance?

One must question why so much attention is now directed towards Adjustable Life. After all, Adjustable Life is not a new product. Minnesota Mutual introduced it in 1971. If Bankers Life's introduction of Adjustable Life is notable, it is, then, assuredly notable for having successfully achieved an outstanding public relations impact.

Underneath all of the publicity and accolades is a product that can be described as innovative; as responsive to the need for flexibility in the protection-saving mix underlying any permanent life product; as significant, having achieved a position of roughly one-third of new business at both Bankers and Minnesota Mutual; and as technically ingenious, having fit an unorthodox product design within a very orthodox regulatory structure, specifically the Standard Non-Forfeiture Law and the Standard Valuation Law.

MR. GERALD R. CHAPMAN: The development of an Adjustable Life policy at The Minnesota Mutual Life was a slow process involving the input of several people. A major contribution was made by Walter Chapin, who has been a consulting actuary for the company.

The upper management of our company, for some time, had been looking for a solution to the problem of a policyholder having changing needs for insurance over time. The problem was easy to define - but the solution was not. As with many companies, our solution to this problem was to issue additional insurance, make a reduction in existing insurance, or exercise a rather expensive-to-perform policy change procedure. We were accommodating our policyholders, but we were not as efficient as we would liked to have been.

About this same time, Mr. Chapin had been looking for a method that could allow individual policies to be amended at some point following original issue - similar to what is being done with group insurance certificates when a change in salary occurs. In 1962, we began issuing a policy which could be amended to increase the death benefit and the annual premium. The increases were on the whole life plan of insurance and were pre-defined as to amount and premium. This policy achieved only limited success in the marketplace.

In retrospect, the policy was still inflexible in that the policyholder could only change the contract when and by how much the contract stated. The policy was attempting to be a "forecaster" of future needs but was not responsive to the actual changes in those needs.

By 1964, Mr. Chapin had made substantial progress in defining his version of a life cycle policy. A program had been written for the computer that demonstrated the feasibility of determining new policy parameters (face amount, annual premium, and plan of insurance) at some point after original issue.

In late 1970, with the intense assistance of Mr. Chapin, our company began a test market of this new view of insurance which we called Adjustable Life. The test market was conducted in selected agencies and was monitored closely. The results of the test market indicated that the public was receptive to the concept of Adjustable Life. These findings were later supported by the 1974 MAP study by the Institute of Life Insurance.

In 1973, we re-filed an improved policy form with several rider benefits and began nationwide marketing. We did not release this policy to all of our agencies immediately as we usually do with a new policy. Instead, an agency was allowed to market the policy only after attending an educational seminar conducted by home office personnel. We consider that this concept of training personnel prior to allowing them to market the policy to be extremely important.

The major developments since 1975 include:

- The publication of Mr. Chapin's paper "Toward Adjustable Individual Life Policies" in the Transactions of the Society (TSA Vol. XXVIII).

- The Bankers Life of Des Moines began issuing their Adjustable Life policy in January, 1977, and has received widespread acceptance from their field force and the public.

- A substantial amount of nationwide publicity in the major publications.

- Today, six, possibly more, companies have expressed a strong interest in developing the product.

With that background information, what kind of sales results have we achieved so far? In our opinion, the new issues results are more than satisfactory. Our Adjustable Life policy now accounts for 39% by number of policies, 30% by volume, and 24% by premium when we look at our entire 1977 Ordinary Life production.

I understand that in their first year of their new sales, the Bankers Life Adjustable Life policy accounted for over 30% of the new business.

As significant as the new issues of this policy can become, we feel the true measure of this policy will occur in the area of contract changes and re-issues.

We expect to be able to offer better service to our policyholders so that they will persist better than with regular policies, and will exercise their "reissue" options as their needs for insurance change.

Even with our limited experience to date, we have found that over 80% of our policyholders reissue their policy within the first three years from original issue. We also see that our lapse experience is better than under our traditional policies.

What are the future expectations for this policy? Do we expect to see the Adjustable Life policy replace our company's entire rate book? The answer is a resounding No! Because we can offer an Adjustable Life policy, we have already discontinued some rather marginal plans during our latest rate book revision. There are also three insurance departments that as yet have not approved the policy form, and we don't really wish to stop marketing in those states. We have some general agencies whose current method of marketing does not include the Adjustable Life policy. It would be a mistake to force them to market this policy.

MS. ALICE M. NEENAN: I would like to talk to you about general product design. Adjustable Life responds to the need for a more flexible individual life insurance product, one that can adapt to changes in the policyowner's financial security needs and ability to pay. In its broadest form, Adjustable Life encompasses a complete family of limited payment life plans and continuous payment term and endowment plans. Of course, a life insurance company may choose to limit the range of plans somewhat, by omitting the endowment forms or by setting a minimum term period of 5 or 10 years. This is, in fact, the case with the Adjustable Life contracts now on the market.

An Adjustable Life policy series consists of just one contract form, which contains all of the usual provisions relating to premiums, non-forfeiture values, policy loans, settlement options, etc.

The unique feature is the adjustment provision, which allows the policyowner to request an increase or decrease in the face amount or the gross premium at any time up to a specified maximum age (which may be 75 or 80). A change of plan readily can be accomplished by requesting the appropriate face amount and premium changes. Of course, face amount increases are subject to evidence of insurability in most cases. At the time of issue or adjustment, the buyer specifies two of the three parameters (plan, premium, and face amount) and the third is then determined.

The computer-produced policy specifications page shows the face amount, gross premium, protection period, and premium paying period. In the case of an endowment form (and that would include retirement income policies as well), the maturity age and the maturity cash value would also be specified. When an adjustment is made, the home office simply sends out a new specifications page to be filed with the original policy. Ideally, a telecommunications system in each agency office would produce ledger statement illustrations for proposals and also for in force policies. A link-up with the home office computerized issue system could allow the printing in the agency office of the policy specifications page for each new issue or adjustment, as well as an annual statement of benefits and values to be delivered to each policy-owner on each anniversary. This could substantially reduce the amount of paper mailed between the home office and the agencies, and improve time service as well.

How does an Adjustable Life plan change differ from a traditional plan change? There is no charge or refund based on the difference in reserves or gross premiums. The cash value stays in the contract, and the size of the reserve at the time of the adjustment is factored into the calculation of the new premium. In effect, the impact of the plan change is spread over the entire remaining premium paying period, rather than being accounted for by a one-shot charge or refund. However, the policyowner who wishes to improve the plan (that is, lengthen the protection period of a term form, or shorten the premium paying period of a life form, or increase the maturity cash value of an endowment form) can do so by the payment of an unscheduled single premium.

Riders are obviously an important factor in product design. Almost any type of rider that is currently being used on traditional insurance products can be adapted to Adjustable Life. I am limiting my comments to the cost of living and disability waiver riders, since accidental death benefit, term riders, and guaranteed insurability are fairly standard on this product.

Cost of Living

Although many variations are possible, the cost of living rider generally provides an automatic increase in face amount with a corresponding increase in premium every three years until attained age 55 or so. There are, generally, underwriting requirements for adding the rider to an Adjustable Life policy, but the automatic increases are made without evidence. The amount of the increase is based on the cumulative increase in the CPI, subject to specified maximums such as 20% of the current face amount or $20,000. If the policyowner refuses to accept an increase, the rider terminates and cannot be reinstated without evidence of insurability. This feature should ensure a high acceptance rate and keep anti-selection within acceptable limits, making it possible to offer the rider without charge. I understand that Minnesota Mutual has had excellent experience with this rider with about a 75% acceptance rate.

Disability Waiver

Disability waiver raises some interesting questions; there are a number of possible approaches. The first would be to waive the gross premium for the plan and face amount that was in force at the time of disability. This could result in some game-playing, however, with disabled policyowners changing from 10 year term to 10 pay life, just before filing the disability claim. Perhaps this could be controlled by limiting the waiver benefit to a specified multiple of the initial premium, with a policyholder option to increase the multiple at a later time, subject to evidence.

A second approach would be to provide for an automatic plan change to whole life, with premiums payable to age 100, while premiums are being waived. This might not seem like a very good deal to the policyowner who had a limited pay life or an endowment form prior to disability, because of the impact on cash values and dividends. The servicing agent might also be unhappy about the resulting reduction in commissions.

A third alternative would be to waive an average premium, based on the premiums paid over a specified period, such as three years prior to disability. This would seem to have some appeal, except to the policyowner who has recently made a substantial increase in premium payments. It also raises the question of whether you would allow the policyowner to adjust the policy while premiums are being waived. For example, would you allow the policyowner to increase the face amount and make premium payments equal to the difference between the new higher premium and the amount currently being waived?

It appears to me that it is not an easy task to design an understandable and equitable waiver benefit which is reasonable to administer.

Guarantees

A basic decision which must be addressed in the design of an Adjustable Life product is the question of whether the original gross premium basis should be guaranteed for all future face amount increases. To do so involves an element of risk, since the premium rate basis must then hold up for 75 years or so. Limiting the original rate basis to some fixed period, such as 5 or 10 years from issue, or to some specified multiple of the original face amount, would allow for less conservative gross premiums. However, the lack of a rate guarantee for future increases might be viewed as a negative factor by the buying public. The question of the insurance company's ability to equitably administer a series of different rate bases must also be addressed.

This issue of premium guarantee should be particularly important to stock companies who are evaluating the feasibility of a non-par Adjustable Life product.

Strengths and Weaknesses

You have probably thought of a number of the strengths and weaknesses of Adjustable Life, but it might be worthwhile to list some of them.

1. The ability to increase the face amount makes guaranteed insurability riders and cost of living riders much more attractive than they are currently.

2. There are obvious cost economies to the buyer in owning just one life insurance policy, and it is easier to keep the beneficiary and address current.

3. In the area of individual policy pensions, the flexible face amount should greatly reduce paperwork for the employer, the agent, and the home office. The cost savings of the single policy approach are probably most important in this market. Also, the ability to vary premiums

from year to year makes Adjustable Life particularly suitable for profit-sharing plans.

4. Adjustable Life is very much oriented toward buyer needs, since the computer can determine the plan which fits the desired face amount and gross premium. The plan can be adjusted to reflect desired changes in the ratio of protection to savings. Substandard buyers can elect a cheaper plan in lieu of a higher premium. In business insurance situations, the corporation can, within limits, pay the same premium for each employee, regardless of age or health by selecting the appropriate plan.

5. Flexible premiums should improve company persistency, since a premium reduction accompanied by a change to a cheaper plan can be done in lieu of a lapse or a partial surrender. Also, the ability to change the premiums allows great latitude in designing graded premium life plans which match the buyer's disposable income.

6. Adjustable Life blurs the distinction between term and permanent, since the term forms have cash values. Term protection to the buyer's life expectancy is more like whole life than yearly renewable term, and the term gradually can be upgraded to permanent insurance through a series of premium increases which allows the policyholder to avoid the large jump in premium resulting from a traditional term conversion.

There are some weaknesses, including:

1. There are some sales situations where it is desirable to have several policies with different owners, particularly for estate tax considerations. Adjustable Life cannot accomplish this particularly well.

2. Assuming that the net cost of a single Adjustable Life contract is somewhat higher than the net cost of a comparable fixed product, the older buyer might prefer a traditional product. He may not feel that he needs flexibility. Few, if any, riders would be available at issue ages over 60.

3. As the Adjustable Life policyowner continues to increase the face amount and premium, it may be financially impossible for him or her to pay premiums on an annual basis. This essentially forces the policyowner to pay more for the coverage, due to the traditional loading on fractional premiums.

4. Adjustable Life is complicated, and the orphaned policyowner or the one with an inadequately trained agent may have trouble making effective use of the contract. A home office commitment to ensuring good service for every Adjustable Life policyowner seems to be essential.

I personally feel the strengths outweigh the weaknesses, and the sales results to date certainly seem to indicate that the buying public has a lot of interest in flexible life insurance products.

MR. JOHN E. ASCHENBRENNER: The approaches to cash values, reserves, net premiums, and plan determination which are used by Bankers Life, Minnesota Mutual and in Walter Chapin's paper are all very similar. I am going to limit my remarks to a general description of this approach and anyone desiring more detailed formulae can look in Walter Chapin's paper.

In these current versions of Adjustable Life, there is a direct tie-in between the cash values, the reserves, the net premiums, and the plan calculations. Reserves under the Commissioners' method are used for both cash values and for statement reserves. There is no theoretical reason that cash values have to equal reserves, but from a practical standpoint this significantly simplifies the administrative process.

In many situations, when a new Adjustable Life policy is applied for, the gross premium and the face amount are specified. The plan is the unknown factor.

1. The gross premium is first unloaded to arrive at a net premium, or β, as it is often called under the Commissioners' Valuation Method.

2. Using this net premium, an expense allowance is calculated, again on the Commissioners Reserve Valuation Method, except modified slightly so that the expense allowance is never greater than that allowed under the Standard Non-Forfeiture Law.

3. The net premium and expense allowance are then used to determine the plan of insurance.

4. Once the CRVM net premium, the expense allowance, and the plan are known, reserves and cash values can be calculated by either a prospective or retrospective method.

In some situations, the face amount and the plan of insurance will be specified rather than the premium and face amount. In this case, the premium would be the unknown and the same steps will be followed except in a different order.

The third possibility would be that the face amount would be unknown. Since the face amount is included in both the gross premium loading formula and the expense allowance calculation, an iterative process must be used to arrive at the correct face amount.

On policy adjustments, the process is essentially the same as the new issues, except for two points:

1. The existing cash value is used as a starting point, and

2. An expense allowance is calculated somewhat differently. The expense allowance is calculated as if a new policy were being issued with the new face amount and new premium level. From this expense allowance is deducted any expense allowance previously taken on the policy to arrive at the expense allowance actually used for the adjustment itself.

Adjustable Life has been considered by the Society of Actuaries' Unruh Committee, which was studying non-forfeiture laws, and their recommendation, essentially, was to build this practice into the law so that there is no question but that it is the correct method to use.

The treatment of rated policies under Adjustable Life is an interesting question. There are a number of different ways that rated policies can be handled. The first method would be to modify the cash value mortality table, and possibly also the dividend mortality table. These modified tables then would be used directly in the calculation of cash values, reserves, net premiums, plan of insurance, and dividends.

A second method would be more similar to the currently used method on traditional policies. On this, the Adjustable Life policy would have standard cash values and dividends but an extra premium would be charged. This extra premium would be determined outside of the regular Adjustable Life calculations of plan and cash values. The extra premium may or may not vary by the plan of insurance.

Under either approach, if a specific premium and face amount are applied for, a rating can be reflected by cheapening the plan rather than by charging an extra premium. This may result in an easier placement of rated policies, but care must be taken that the policyholder realizes he is being rated.

Undoubtedly there will be some policies where the rating at an adjustment is different than that at the original issue of the policy. This could be handled either by issuing a new policy every time the rating changes (a less than satisfactory approach) or by a more complex method of combining multiple ratings in a single policy.

Adjustable Life guarantees the right of the policyholder to make adjustments, but each company that issues Adjustable Life will have to decide for itself whether or not to guarantee the cash value method and the premium basis on which these adjustments will be made. If Adjustable Life is considered a single on-going policy, it would be difficult to not guarantee the cash value method and assumptions. In fact, in the future, when methods and factors in the Standard Non-Forfeiture Law are revised, I believe that the law in effect at the time of original issue of the policy should apply, not the law in effect at the time of the adjustment. To do otherwise would entail a mammoth job of trying to determine which method is more favorable on a policy-by-policy basis.

The gross premium loading formula is a little different question. An Adjustable Life policy probably could be issued with guaranteed cash value method and assumptions, but with a loading formula which is subject to change at each adjustment.

However, from a practical standpoint, any changes in cash value method or loading formula on an existing policy could easily result in policyholder dissatisfaction as well as creating additional administrative and EDP complications.

This brings up the question of participating versus non-participating Adjustable Life policies. I think it would be extremely difficult for a company to design a competitive yet a safe pricing structure on a non-par basis if the cash values and gross premiums are guaranteed for all future adjustments.

MR. TURNER: What considerations generally determine the range of plans permitted within an Adjustable Life plan design?

MR. ASCHENBRENNER: We found that it is extremely difficult to design a loading formula and a dividend formula that will apply over the entire range of plans and adjustments that could be made under a policy. The extreme ends, such as one-year term or single pay life, cause pricing and consistency problems.

MR. CHAPMAN: We have discovered some problems at the low ages.

MR. ASCHENBRENNER: One other point is that the product is significantly simplified when it is limited to the term and limited pay life range. You bring in a lot more complications when you try to build in endowments or retirement income.

MR. BERNARD FENSTER: What do you do with your non-forfeiture page in the policy - does that get changed as part of your schedule page every time an adjustment is made?

MS. NEENAN: Yes, you do send out an entire new specification page with all of the new values, cash values, paid-up values, and so on. The policyowner would just file them with his contract. Presumably, you would have the adjustment date on it so if he did not throw out the previous specification page, he would be able to tell which was the most recent by looking at the date of re-issue or the date of adjustment.

MR. BRUCE A. CARLSON: When you quote your sales statistics, do you have a feel for whether your growth rate is increasing because of the product or if the sales are simply substitutes for other life sales that would have been made?

MR. ASCHENBRENNER: Most of the sales, probably, are a substitute for other products we would have issued anyway. We have done some studies, and it appears that we may be getting some new business we would not have gotten. Hopefully, the true impact of Adjustable Life will come in the future when we start seeing the repeat sales and increases on existing policies.

MR. STEPHEN H. LEWIS: With respect to the policy enhancement dividend option, are changes resulting from that reflected in the policy schedule page and, if so, how often is that schedule page up-dated?

MR. ASCHENBRENNER: At Bankers Life, changes due to the policy improvement dividend option will be reflected in a new set of data pages every third year. In the intervening years, a brief policy report will be mailed to each policyholder summarizing the effect of policy improvement.

MR. LEWIS: In seeking approval of the policy form, did the states have comment on how often you up-date that schedule page?

MR. ASCHENBRENNER: I am not aware of any comment on that.

MS. NEENAN: Adjustable Life is an exciting challenge for marketing people, and may force us to spend more time looking to the future and trying out new ideas.

The compensation system is clearly an important factor in the success of an Adjustable Life product. Ideally, the life insurance company should first identify the types of sales and service activities the company wishes to encourage, and then design a compensation system which rewards these activities. To the extent possible, the system should also fail to reward those activities the company wants to discourage. That statement may sound pretty simplistic, but how good a job have we really done in matching agents' compensation with corporate goals? The next step, as I see it, would be to evaluate the impact upon agent incomes and upon the company's computer systems. A commission structure based on great theory is doomed to failure if it is unacceptable to the agency force, or if the commission accounting system cannot be programmed to ensure accurate and timely payments to the field force.

Some insurance companies might view Adjustable Life as a unique opportunity to introduce an innovative compensation system. For example, there could be a factor in the commission formula based on the increase in face amount, or the agent could be paid a fee for each service performed for the client, or a new type of persistency bonus could be based on net cash flow into the agent's entire block of business (taking into account all transactions relating to premiums, dividends, and policy loans).

On the other hand, a company might prefer to avoid taking a chance on a radical departure from its current commission structure. Given the amount of time and effort required to implement Adjustable Life, the wrong decision on compensation could be very costly. Obviously you can pay a first year commission on increases in premium and generate a series of vested renewals on that increase as well. The "catch" is that this rewards the situation where the premium seesaws up and down. Commission chargebacks are a possible solution, but this is fraught with administrative difficulties, as well as agent morale problems. A better idea might be to calculate the increase by comparing the new premium against the highest annual premium paid within a specified period, such as the previous three contract years.

The traditional type of commission scale certainly rewards the agent for premium increases, but some might argue that it does not provide sufficient compensation for other types of service. This issue is particularly important in the pension area, where level commissions payable for the entire duration of the contract seem to make a lot of sense, especially if there is some transferability of renewals. Of course, commission disclosure is another incentive for getting away from a front-end loaded commission scale. The major drawback to this approach is the impact on agent incomes in the first year or two after the introduction of Adjustable Life. With inflation pushing expenses steadily upward, agents naturally are concerned about abrupt decreases in first-year commission rates. I am sure solutions can be found, but this illustrates the difficulties involved in the design of an Adjustable Life compensation system.

Sales supports are as important as compensation in determining the success of an Adjustable Life marketing effort. A flexible, computerized proposal system which allows the illustration of a series of adjustments is a necessity. A similar illustration service is needed for in force policies to enable the buyer to make effective use of the adjustment provision. Traditional ratebooks simply do not work with Adjustable Life. In the first place, it is not feasible to print rate pages for every conceivable plan. Secondly, it is impossible to print rate tables for plans which have been adjusted, because the amount of reserve in force at the time of change effects the calculation of the new values. Adjustable Life is truly a product of the computer age, and both the home office and the field must rely heavily on modern technology.

Disclosure of interest adjusted costs does not appear to have a great deal of significance with Adjustable Life. How can you really compare a conventional whole life policy with a term to age 73 policy which is expected to go through a half dozen adjustments in the first twenty policy years?

Joseph Belth did a cost study for the May, 1978, issue of Money Magazine based on his retention method, and he found that Adjustable Life policies had lower costs than three-quarters of the 163 policies analyzed. My personal feeling is that we should avoid over-emphasizing cost comparisons, at the expense of overlooking the key factors of benefits, flexibility, and service.

The question of cost comparisons, however, inevitably leads to the issue of replacements. The benefits of Adjustable Life for individual policy pensions seem so obvious that most employers are likely to want it for their past as well as their future purchases. Presumably the same replacement pressures exist in the personal insurance area, although on a smaller scale. At Connecticut Mutual, for example, about half of our non-pension policyowners own three or more Connecticut Mutual policies. Switching all existing insurance reserves into an Adjustable Life contract could be advantageous for some of these policyholders. A switchover procedure seems like a logical service to offer, and moving policy reserves into a block with a more modern reserve basis can result in substantial Federal Income Tax savings for the company.

So why would there be any question about the value of a replacement program? The term "replacement" can trigger negative reactions. Although a program might be set up solely for the purpose of accommodating requests from existing policyowners, a company might quickly find itself replacing large amounts of insurance with other companies. Even though such replacements may be to the buyer's advantage, this could turn out to be a very sensitive issue for the life insurance industry.

On the practical side, there are the problems of setting up procedures to determine whether the replacement is to the insured's advantage and the cost of administering a replacement program. How will you handle commissions, particularly when several agents were involved in the sale of the original policies? To refuse to do replacements would be difficult to reconcile with a marketing philosophy that one flexible policy is generally a better deal for the insured than a collection of small traditional policies.

There has been a great deal of replacement discussion in the past year or two, and Adjustable Life is likely to accelerate the controversy.

MR. ASCHENBRENNER: I would like to make three points on the marketing issue.

1. The marketing of Adjustable Life (particularly adjustments and rated policies) is almost entirely dependent on the computer to illustrate values.

2. Adjustable Life requires good, quality, on going service for it to be successful.

3. I do not think Adjustable Life has to be difficult for agents and policyholders to understand.

To elaborate slightly on this last point, I am going to borrow an analogy made by Stan Hill in the Adjustable Life session at the Dearborn meeting of the Society of Actuaries. He compared Adjustable Life to a new car with an automatic shift, power steering and brakes, cruise control, air conditioning and various other options. If you lift the hood, this car looks much more complicated than cars of 30 years ago. Few owners of this car will understand or really want to understand how everything under the hood works, but it is certainly easier and more comfortable to use than the car of years ago. Adjustable Life can be looked at from the same standpoint. The formulae behind it are extremely complex but what the agent and the policyholder see should be a good product for them.

MR. ROBERT J. BOHN: Is anyone aware of how many additional companies might be in the marketplace for this product within the near future?

MR. ASCHENBRENNER: We believe that there may be approximately six companies that are seriously looking at it. As far as their respective time schedules, I do not have any information.

MR. C. LORNE CAMPBELL: What are the current practices on commissions when the premium changes at some point in the future?

MS. NEENAN: It would be extremely difficult to have different commission rates for different types of plans even though, traditionally, companies might have paid higher commissions on life than on term.

MR. ASCHENBRENNER: A premium increase generates new first year commission unless it follows shortly after a premium decrease. In that case, the amount of increase beyond that which brought the policy back up to where it was in the prior period would be brought in at the point of the scale where the decrease occurred.

The two points that have to be considered when pricing Adjustable Life are safety and competitiveness. A third factor that comes in is consistency. Consistency must be maintained both within the entire range of Adjustable Life plans and possible adjustments and with other portfolio products. It is difficult to develop a single loading formula, a cash value method, and a dividend method which produce consistent and reasonable values over the entire range.

The method that will be used for dividends on Adjustable Life probably will be largely influenced by what a company does on traditional plans.

A three factor approach seems to work quite well. Recognition of the duration of the various pieces of coverage and pieces of premium is probably needed to get an equitable distribution of surplus.

A second approach to dividends is more of an asset share or fund approach. A dividend fund could be carried along for each individual policy. It may not be a true asset share in that acquisition expenses may need to be spread over a number of years. The dividend each year would equal the difference between this dividend fund and some target fund such as the cash value.

Because of the newness of Adjustable Life, any assumptions as to experience under this policy are nothing more than an educated guess.

At any point in time, some Adjustable Life policies will be of the term variety while others will be of the limited pay life variety. Mortality can be looked at in two ways. It can be varied by plan of insurance or all plans of insurance could be lumped together. The ability to adjust the plan and the premium level freely without any underwriting requirements will probably add some adverse mortality. Cost of living, if combined with other increases, will probably add some mortality. But, hopefully, with the controls on cost of living and with the high acceptance rate we are hoping for, it should not add much cost.

I do not know that there is any reason to vary the interest assumptions on Adjustable Life other than the possibility of different tax consequences.

Hopefully, lapse experience will be better on Adjustable Life than on traditional policies since many of the traditional reasons for lapse will be absent. The premium, plan and/or the face amount can be adjusted to fit the insured's new circumstances, rather than needing to lapse a policy.

It is difficult, though, to really define what a lapse is on an Adjustable Life. Are lapses defined as actual termination of a policy, a decrease in face amount, decrease in premium - what is a lapse? This answer will vary depending on why lapses are being measured - whether it is for dividend purposes, agent compensation or some other reason.

I think the risk charge, or contribution to surplus, on Adjustable Life might be greater than on traditional policies because of the long term options and the uncertainty of Adjustable Life.

MR. DAVID M. MORDORSKI: Have any of the companies marketing Adjustable Life not had rate guarantees in their contracts, and if so, did they run into problems with the state insurance departments on approvals where they said that changes made six or seven years down the road will be according to the premium rates redetermined at that time?

MR. ASCHENBRENNER: I am not aware that any policies specifically guarantee the gross premium rate for future adjustments. I have not heard of any approval difficulties because of this.

MR. TURNER: There is an interesting alternative, and it would be a non-par version with non-guaranteed gross premiums. This may reflect in a published set of guaranteed maximum premiums with "current" gross premiums determined from time to time by the company. This should avoid deficiency reserves in most states, and should provide you with a contingency margin equal to the difference between current rates and the guaranteed maximum rates. I think the non-par version with non-guaranteed rates would be feasible; I have seen, for example, whole life contracts with non-guaranteed gross premiums.

MR. CHAPMAN: The area of administration and systems can make or break your record with Adjustable Life. If you do not have good administrative systems, you could forfeit any momentum built up in the field force with the introduction of this policy. Once you destroy that momentum, I do not think you can get your field force to market this policy again.

It has been said that "The age of a person can be determined by the amount of pain experienced at the reception of a new idea." When you begin with Adjustable Life, you will find that your administrative system is a very old and tired man, one resisting change to the end.

When preparing a system to administer the Adjustable Life policy, there are two broad approaches from which you can choose. Either you can totally revise or rewrite your current administrative system, or you can choose to augment your existing system with parallel system(s).

Augmenting your existing administrative system will allow you to get into operation sooner and will provide a period when unforeseen "bugs" can be corrected. This method will also better prepare you for consolidating your systems in the future. This is the method we chose, and we have not discovered any problems with it. The last time I heard the figure for the average life span of an administrative system, I think it was somewhere in the neighborhood of 10 to 12 years. You will not have very long to wait before you consider the problem of consolidation of systems.

The first approach, the total system rewrite, has its flaws. A minor flaw with this approach is that the first item - of many - to be deferred until after implementation is going to be the Adjustable Life portion of the system. It is just too complicated.

Since we are in the process of implementing a new administrative system, I would like to relay to you the only thing that we are certain that we have learned about new administrative systems. The development of the new system will obey Golub's Law #1, which states that "No computer system was ever installed on time, within budget, completed with the same personnel that began the system, nor did what it was supposed to do. Yours will not be the first." Our system did not violate that law, not a single part of it.

The broad areas of administration and systems work that will now be covered are:

the actuarial calculations,
the administrative record,
the policyholder services,
and valuation methods.

You cannot drop the Adjustable Life formulae into the lap of the systems people and then walk away. You must plan on substantial actuarial support in the design, testing, and maybe even the programming of these formulae.

This may be a different approach than you are used to--it was for us. We had never put our premium and dividend formulae into the computer. We would just load in the values that the formulae would produce. But now with Adjustable Life, we cannot load the values into the computer--they are uniquely determined for each policy.

Another caution would be to check the accuracy and consistency of the formulae when in computer code. Once the coding is put into production, the area that is going to be performing any "reasonableness checks" is going to be the administrative unit.

After having mastered the formulae, we did notice that there is a problem of retaining the required information in a fixed length administrative record.

At the Dearborn meeting, it was stated that there are approximately 60 "new items" required for a master record of an adjustable policy over and above the items required by an ordinary life policy. When a reissue is performed, some of these "new items" are updated. This is how we create the "historical integrity" of Adjustable Life.

Granted, the original master record of an Adjustable Life policy does require more storage space than a regular policy, but it is less space than the total of two or more regular policies on the same insured. This is one of the advantages of Adjustable Life.

One example of these "new items" is statutory expense loading. If you decide to calculate reserves and/or cash values by the Commissioners Reserve Valuation Method, you will have to keep track of this item. It will be used at the point of every reissue. If you can afford to use the net level premium method, obviously you can ignore this item.

Another important example of the "new items" relates to commissions. You may decide, as we did, to use the "layered approach" to calculating commissions. The "layered approach" is simply a means of keeping track of each new piece of premium--whether it is base policy premium or rider premium. With this approach the computer can determine commissions for an agent based upon the amount of premium he has produced on the case.

If you use this approach, you will have to retain the following items in your administrative record:

1. The code of the agent responsible for an increase in premium;

2. The amount of the additional premium added; and

3. The effective and termination dates associated with the additional premium.

This approach to calculating commissions is an equitable method and easy to explain to agents. The agents begin to realize that they will receive commissions based on the amount of new premium they personally produce on a case. This approach does complicate record processing and later record alteration, but will minimize commission problems and also assist in a persistency bonus calculation or determination of production credit items, such as production bonus or MDRT.

Once we have decided upon the total administrative record, we should consider the area responsible for the administrative record - policyholder services. We treated the policyholder services for the Adjustable Life policy in the same manner that we augmented our basic computer systems. We created a separate unit that would be responsible for the reissue process. The uniqueness of the Adjustable Life policy could not fit into our existing policyholder services operation.

Later on, this unit was to become the forwarding point for all administrative problems involving the Adjustable Life policy. As with our supplementary system, we expect to consolidate this unit back into the regular policyholder services area when we begin under a consolidated system.

With the flexibility of the Adjustable Life policy comes the problem of being able to cheaply and accurately alter all records which may change due to a reissue. You may discover that your current procedures must be streamlined in order to accommodate an increase in volume of changes. Hand adjusting records is an unsatisfactory method.

Our conservation unit has also found that the decrease in premium facility is a valuable tool. Rather than lapse a policy when a temporary financial reverse occurs, the policyholder may decrease his premium while keeping the death benefit level. When circumstances improve, the premium may be returned to its former--or hopefully a higher--level. Currently, we are observing that only about 7% of our reissues involve a decrease in premium.

Currently there are four methods of performing a valuation:

1. Seriatim
2. Attained Age
3. Group
4. Retrospective

Only the seriatim and attained age methods can be used with the Adjustable Life policy. The group and retrospective methods cannot be used because of the requirement of rather homogeneous groups.

The seriatim method may become the preferred method for calculating reserves. After individual reserve values are calculated, the grand total can be summarized however desired whether it be by life-term or male-female.

The attained age method can also be used with this policy. This is the most efficient method from the viewpoint of use of the computer but may require the actuary to review the definition and use of the attained age valuation factor. This method will not allow totals to be subdivided in any other manner than by attained age.

MR. GARY N. SARGENT: Do you consider the following idea potentially feasible: the creation of a universal life type systems design, under which a portion of the premium is used to purchase one-year term insurance, with the balance being used to fund an annuity, in order to support an adjustable life type design?

MR. CHAPMAN: At this point it is a possible alternative - it is a refinement of what we are doing. Certainly, it would complicate matters.

MR. TURNER: I think this concept takes you back to a variable life or variable annuity type of product. I doubt if you could support normal commission loads and expense loads on a product that is so heavily a savings-orientated product.

MR. CAMPBELL: When the existing products were being developed, how were future changes anticipated in asset share runs?

MR. ASCHENBRENNER: There are some extra expenses associated with the availability of the Adjustable Life system. We spread this cost over all Adjustable Life policies even if an adjustment is never made on a particular policy. There is, also, a cost associated with actually making an adjustment. This expense is charged to a policy only when an adjustment is made on that policy.

MR. WILLIAM L. HEZZELWOOD: The term MDRT was mentioned by Mr. Chapman on non-Adjustable Life products. I am sure you know the MDRT only allows reduced credit for term insurance. What rules or guidelines has the MDRT announced as far as giving credit for Adjustable Life policies? Say a person buys an adjustable policy and initially it looks like a term to 65 policy but two years later he changes it to a whole life policy. Will you be allowed to award the additional credit at that point?

MR. ASCHENBRENNER: The Million Dollar Round Table has not announced any rules or guidelines for Adjustable Life. Bankers Life and Minnesota Mutual are using the reduced credit for any plan that turns out to be term insurance. A policy that starts out as term but later is adjusted to whole life will generate an additional credit at that point. This method of handling Adjustable Life has been filed with the MDRT and no objections have been received.

MR. CHAPMAN: I think there are brackets depending on the period for which premiums are to be paid. The percent credit allowed is rather low on short duration plans.

MR. BOHN: Would you comment about the staffing of the separate administrative unit for the servicing, including the amount of actuarial personnel involvement?

MR. CHAPMAN: Currently, at Minnesota Mutual there is a unit that has a supervisor, and there are six clerks. The supervisor reports to an actuarial assistant. We do not anticipate it is going to get any larger than it has. These employees do not perform any regular policyholder services.

MR. ASCHENBRENNER: Bankers does not have a separate unit. We have worked our operations into the existing departments and areas.

MR. LEWIS: Which plans have proved most popular at issue?

MR. ASCHENBRENNER: It leans toward the term side.

MR. LEWIS: For term plans, the policy improvement dividend option provides extended coverage. For any given issue age, there is a term plan which, as a result of the policy improvement dividend option, would gradually be transformed into whole life coverage. Is this term plan particularly popular?

MR. ASCHENBRENNER: Yes, that plan is popular at the Bankers. The policy improvement dividend option is where the dividend is added directly to the cash value each year. If the plan happens to be term insurance, the dividend is used to lengthen the term of the policy. If the plan is a limited pay life variety, the face amount of insurance is increased just as with a dividend addition.

MS. NEENAN: The question any large company must ask itself is not "Will we develop Adjustable Life?", but "How soon will we do it?" Conventional whole life has been a good product for a long time, but in an era of inflation, changing lifestyles, and advanced computer technology, I do not see how we can deny the appropriateness of Adjustable Life.

Of course, small companies will find it much more difficult to allocate the resources needed to develop an Adjustable Life product, and they may choose to wait several years before making any decision.

It is interesting to speculate on what the industry might be like in another five or ten years if most of the large companies are marketing Adjustable Life. Most policyowners could be effectively "locked-in" to the company from which they purchased their Adjustable Life contract, because adjustments should be easier and cheaper than making any new purchases. Many traditional policies could have been replaced with Adjustable Life. Suppose, essentially all but the oldest and the youngest of the insured population have purchased Adjustable Life. Then each life insurance company's market for new sales would effectively be limited to its current block of policyowners. (That is, new sales would consist almost entirely of increases to existing policies.)

I admit this is a pretty wild scenario, but if it ever happened, the life insurance company which made an early entry into Adjustable Life would have a significantly larger market share than a similar-sized latecomer.

MR. ASCHENBRENNER: When I first started working on Adjustable Life, I thought of it as an interim product. It was really only an initial step toward a more completely flexible and open policy. A completely open policy was not yet practical because of regulatory and tax questions, and because the field and the insurance buying public were not yet ready for it.

I still think that Adjustable Life is going to evolve and change in the years ahead, but for the average insurance buyer I think we may have gone as far toward an open policy as we should go. By hanging onto some of the ties to traditional insurance, we have retained a very important concept - the plan of insurance. At any time, a policyholder knows exactly what he has. If he continues with the current premium and the current face amount, he knows exactly how long his coverage will last and how long his premiums must be paid.

I think Adjustable Life may well spread throughout the industry, but it will be a slow process because of the large amount of time and expense involved in developing the product.

MR. TURNER: As has been acknowledged by the proponents of Adjustable Life, the ultimate test is going to be in the marketplace. One can view the marketplace as comprised of either agents, or policyholders, or both.

Adjustable Life is, first, a more practical alternative than a fully flexible plan for most of the companies which comprise the industry. Adjustable Life does not imply the need for a concurrent overhaul in the distribution system; it will support "normal" sales compensation levels. Acceptance by a life company's sales force is and should be expected, since their position is not worsened and, if anything, is enhanced by the improved saleability of the product through the additional product features offered (e.g., flexibility).

Second, it has been observed that Adjustable Life does not represent an improvement over orthodox products in terms of the utilization of life insurance as a savings vehicle. As it has been described by others, it is less competitive from the consumers' viewpoint than a current similar product offered in an orthodox product portfolio. Obviously, you cannot preserve and support a current distribution system and offer a more competitive savings product to the consumer.

From the company's viewpoint, Adjustable Life is an expensive undertaking, and is probably too expensive for a lot of small companies. This brings me to one other point. What is needed I think, if possible, is a simpler product - simpler from both a sales viewpoint and an administrative viewpoint. Existing plans utilize CRVM reserves as cash values. The problem is that it is not possible under the CRVM method to predict a pattern of initial expense allowances because they are dependent upon the plan of insurance, premium, and age. The ideas underlying an alternative are as follows:

> The policyholder would select the level face amount and specify the initial premium which would apply for a predetermined period of, say, 10-15 years. The plan of insurance would always be modified-premium whole life. The Company would solve for the premium required beyond the initial period. At a subsequent adjustment date, a new initial premium would be payable for a similar predetermined period beyond the date of adjustment. Thus, the plan would always be modified-premium whole life at issue, and there are three possible premiums -- the selected premium, the completion premium, and, of course, the unscheduled premium.

The adoption of this format would not significantly restrict the flexibility of the plan from the policyholder's viewpoint. If he does not like the size of the completion premium when the initial period is up, he simply makes an adjustment to whatever premium level he prefers. The proposal does, however, have a major advantage: the amount of the initial expense allowance available under the Standard Non-Forfeiture Law (not the Standard Valuation Law) now includes a predictable element equal to $20 per $1,000 irrespective of plan, age at issue, or amount of initial premium.

The cash value might be defined as follows: The initial expense allowance would be $20 per $1,000, and the net premium would be, say, 90% of the gross premium.

In this form, the initial commission should logically be related to the face amount, probably with an inside limit based upon either the initial or the aggregate premium. For example, the initial commission might be $10 per $1,000, limited to 75% of the premium paid. If this was linked to the aggregate premiums paid, it would result in some of the initial commission being paid in the second and third policy years.

If a subsequent adjustment were made, an additional expense allowance would be charged if the adjustment involved an increase in the amount of insurance. Adjustments involving changes in premium only would not produce additional expense allowances or additional initial commissions. The result, of course, would be a levelling of the commission across plans.

MR. E. BRIAN STAUB: You might be interested in what we have been doing on Adjustable Life. We are a multiple line company, and our agents would dearly like a very "simple" product like this. I say "simple" from the field standpoint - but monstrously complicated from the home office standpoint. We have done considerable preliminary work with Messrs. Chapin and Hill. As of the moment, we have backed off because of EDP problems, but we hope that we will be able to get back into this when our priorities are squared away. Our field force is a "package-type sales" field force. In our company, advanced underwriting means that our agent gets there in advance of the next agent. This product is ideal from our marketing standpoint.