RECORD OF SOCIETY OF ACTUARIES
1980 VOL. 6 NO. 1

THE FUTURE OF PERMANENT LIFE INSURANCE

Moderator: JAMES F. REISKYTL. Panelists: ROBERT K. DICKSON, JR., JOHN R. GARDNER, SPENCER KOPPEL

1. Balance Between "Risk" and "Investment" Functions within a Policy
   a. Traditional Products
   b. Life Cycle/Adjustable Product
   c. Deposit Term
   d. New Designs
2. Regulation and Taxation
   a. Nonforfeiture Values (Guaranteed? Flexible?)
   b. Policy Loans (Required? Rate?)
   c. IRS, SEC, NAIC, FTC, etc.
3. Agents' Compensation/Distribution System
   a. Will the System be Changed to Survive the 1980's? Must it Be?
4. Will Traditional Non-participating Coverage be Replaced by Non-guaranteed Non-par Coverage?
   a. Marketing
   b. Competition with Participating
   c. Replacement of Existing Business

MR. ROBERT K. DICKSON, JR.: Before getting into the various issues and scenarios, I have an admission and an observation. The admission is that I don't know any more about the subject than most of you. Our job isn't to give you "the answers" but simply to stimulate your thinking. I must also admit that most of my remarks aren't terribly original; I've borrowed most of them from someone else. My observation is that I find all three of our scenarios fun to play with but I have concentrated on Scenario 1, the high inflation scenario, and would certainly urge you to do likewise, while at the same time remaining as flexible as possible in your fundamental product and marketing strategy so that you can respond to rapid changes in the environment. By the way, you'd better make sure you have a clear, well thought out product and marketing strategy and that you regularly review it in light of the changing environment.

Double digit inflation and a "consumption" orientation suggest a continuing shift from permanent to term. Over the past 10 years the term/permanent volume ratio for the industry has gone from 40% term/60% permanent to 55%/45%. A few companies such as Connecticut Mutual have bucked that trend. Even the latter fact is not all that reassuring since the frequency of financed insurance selling was undoubtedly increased. The dual income family phenomenon could accelerate the shift to term since available research indicates they are low savers.

Workers will press for greater employer-provided benefits including group term. Most individual term will be annually renewable and it's likely the "revertible" approach (i.e., very favorable long term rate guarantees available to those who can requalify as standard risks every 3-5 years) will become more popular. As happened with group life, a YRT rate war is likely, particularly given the rapid improvement in recent and projected mortality. Decreasing term should become increasingly important as a "term and invest the difference" component and also for mortgage insurance on wildly inflated housing values. If this does happen, we can expect to see more aggressive pricing of decreasing term, perhaps on a YRT basis. Given the growth of dual income families, joint life term coverage payable on the first death could become more important. Stock brokerage houses can be expected to increase their efforts to break into the insurance business and they'll do it with term plus investment packages.

Traditionally designed and priced permanent plans will lose appeal among all income groups. Middle income buyers won't be able to afford it and will have been "brainwashed" by FTC, etc. Upper income buyers will increasingly insist upon a return that is more in tune with inflation. Financed insurance sales will become even more common than in the recent past.

Gross premiums for cash value plans will be further reduced despite the pressure this may put on agent incomes; the trend will be facilitated by the adoption of higher reserve and nonforfeiture interest rates. Non-smoker pricing discounts will become universal to meet competition or regulatory mandate. Graded premium contracts, which represent a hybrid between term and permanent, will assume greater prominence and with much longer grading period (e.g., 10-20 years and longer). My guess is that joint life permanent coverages payable on first or second death will become more important for the two-career couple. Lower premiums will be the main attraction. Helping to offset the drift to lower premiums per $1,000 will be COLA features which produce "automatic" increases in coverage and premium.

Replacement activity will be commonplace since it will be difficult to protect existing permanent insurance against high interest vehicles of all sorts, and, at least where appropriate safeguards are met, the regulators will have removed the stigma from such activity. Single premium life based on high interest rates, and perhaps utilizing the "revertible" idea, will feature very low premiums and, if the law does not change, an attractive tax preferred inside buildup. The preceding comments should not be taken as a sign that I am personally pessimistic about the future of cash value insurance. Clearly there are serious threats to its survival, and it will have to adapt. But I feel its fundamental strengths will permit it to survive and flourish, at least in the so-called advanced sales markets of business insurance and estate planning. Business buy-out values will escalate as will the values of key executives and the appeal of tax deferred/leveraged, non-qualified fringe benefits. Keep in mind that there are 3.5 million small businesses in this country, 70% of which have no business-related life insurance and 75% have no disability income (January, 1979 Best's Review). That's a huge market. The inflationary scenario suggests rapidly growing estates and greater liquidity needs for estate taxes. Fortunately, real incomes should also be increasing thereby producing the ability to pay. The Conference Board has made a series of personal income and wealth projections for the 1980's. Their report predicts dramatic growth of incomes over $35,000 (from 7 million to 14 million households) and also rapid growth of estates over $500,000. These projections are in 1978 dollars.

These facts combined with the continued "graying" of America during the 1980's will mean there are more and more people in the over 45 age group who not only have the ability to pay and a growing sense of their own mortality but also larger and larger estates to protect. Permanent insurance will continue to best meet these needs in my view.

The incentive and investment scenario or the "good old days" future is a lot more pleasant to contemplate than either of the other two. The total demand for life insurance will grow rapidly. Term will grow in relative popularity for several years due to the residual effects of the FTC, consumerists and the inflationary 1970's; however, cash value insurance will enjoy a renaissance particularly in the middle income markets. Stock brokerage houses will continue to find it difficult to sell life insurance and will opt to concentrate on their traditional products thereby further diminishing the drift to term. Savings bank life insurance (SBLI), on the other hand, will become a much more powerful force as most states permit its sale and in larger amounts than during the 1970's. Their marketing strategy will be to emphasize convenience, lack of "pressure selling" and low cost -- especially the latter. Price competition is here to stay regardless of what the FTC does and SBLI will be formidable competition. Witness New York State where the banks are limited to $30,000 and yet the system in total ranked fifth in terms of new business issued in 1979. It's likely that SBLI will lose some of its modest cost advantage due to fairer tax treatment, increased marketing costs (advertising, staffing, etc.) and increased administrative costs as a growing block of business in force requires servicing. My expectation is that in a moderately inflationary growth environment, SBLI will continue to emphasize permanent plans rather than term. It's not at all clear to me in which market segments the bulk of SBLI sales will be made, but I suspect it will be the middle income market, and that will force the traditional companies into greater use of streamlined issue, mass merchandised, low-load coverages in order to compete. Is it also possible that life companies will offer more traditional "banking services" and compete well due to interstate advantages as the population continues to be more mobile? In the upper income market a much higher degree of personal service will continue to be demanded (i.e., the agent), although only the most competitive companies with the strongest field forces will be able to operate in this sophisticated segment.

While the environment for permanent insurance will be much healthier, price competition will still produce much of the same evolution suggested under the high inflation scenario, but for somewhat different reasons and perhaps at a different pace. Due to the appeal of the large case, "advanced sales" markets will result in products and underwriting methods specifically designed for those applications. The older age market for permanent insurance should be particularly robust, given price-competitive products.

With the social democracy scenario, I think we have to be terribly concerned about the middle income market for individual insurance in an environment where Social Security taxes are over 20%. Not only that, but if we were to truly follow the Scandinavian model (take Sweden for instance), other public- or employer-paid insurance and welfare benefits would probably add another 20% to that percent of the payrolls. Perhaps some reassurance can be drawn from the fact that in Sweden total private life insurance in force as a percentage of GNP has tracked quite closely to that of the U.S. over the past ten years. In both countries total insurance in force is roughly equivalent to the GNP, but in Sweden 88% is group versus 46% here. At the end of 1977 individual life insurance in force in Sweden (85% of which was permanent) was around $10-12 billion relative to a GNP of about $85 billion. The comparable U.S. figures were $1.3 trillion in force vs. a $2 trillion GNP.

I would expect this scenario to result in a continuing strong trend to term for the industry taken as a whole. The reasons for this are:

(1) The likelihood of dramatically higher Social Security taxes. (By the way, I'd expect to see general revenues used before we'd get anywhere near 20%, but the net result could well be the same.) Such taxes will have a depressing effect on discretionary incomes and the ability to save through life insurance or anything else.

(2) If inflation moves from 15+% to 5% over several years there will clearly be a residual attitudinal bias in favor of term. Those companies that are oriented to the upper income tier will probably continue to sell a fairly high percentage of permanent as inflation subsides. If estate taxes reach confiscatory levels, but income taxes do not, then estate planning opportunities will explode and permanent life insurance should continue to be entirely viable. A lot depends on what happens with taxes, including the possibility that, at least for small policies, premiums for cash value insurance might become tax deductible as in the United Kingdom, Sweden, etc.

Turning now to life cycle or adjustable products, in the high inflation scenario I see the products offered by Bankers Life and Minnesota Mutual as having somewhat less appeal at least with respect to the "flexibility" per se. I say that because the product isn't especially cost competitive (that's not its strong suit), and I wonder how much extra buyers will be willing to pay for flexibility during an extended period of high inflation. Most adjustable life sales will be of the term variety, but they won't be competitive with pure yearly renewable term plans available in the marketplace. I'd be concerned about premium reductions on those rare sales that contemplate a significant savings element. The cost of living, face amount increase feature will certainly be in tune with the times, but other companies will offer something similar on conventional products.

The likelihood is that new, more aggressive "life cycle" forms will be designed which, in one way or another, combine term with a variety of investment vehicles. Such packages may not differ fundamentally from traditional "term and invest the difference" approaches except that both components may be low load/commission and highly flexible. The term death benefit could be coordinated with the investment fund to produce a total death benefit which is level or which varies according to a predetermined schedule or changes in the CPI. The investment element might offer a range of options from guaranteed principal, probably with an investment year method (IYM) return, to money market or stock separate accounts. Unless the tax law changes, the guaranteed principal version will undoubtedly be an annuity in order to provide a tax deferred buildup. Such a product could be quite competitive and popular with stock brokerage houses who are used to low commission structures. E. F. Hutton's Life of California subsidiary is offering "Total Life", a primitive version of such a product, today.

Such products should have increasing appeal in the more stable environment of the incentive and investment scenario. People's needs do change over time and inflation will continue to haunt buyers for some time to come; that's the appeal of life cycle products. As was true in the 1970's adjustable life buyers will tend to be younger, and sales will be quite heavily term that build modest cash values, although the product should come to be used increasingly in the advanced sales markets where the advantages of flexibility have yet to be fully realized. I would not expect Hutton's "Total Life" to be nearly as serious a threat in this environment.

Higher retirement ages and longer life expectancy spell attractive opportunities for older age sales for estate planning and retirement supplement; these will be savings-oriented sales.

As for the social democracy scenario, relative stability and moderate inflation should be quite conductive to the growth of adjustable life. Assuming the emphasis continues to be on flexibility rather than cost, it will remain primarily a product of the younger and middle income market. If permanent" premiums become partially tax deductible, adjustable life sales could be stimulated to the extent that the level term variation has cash values and might qualify.

MR. SPENCER KOPPEL: I was very careful in reviewing the three scenarios to see that, while the definition might be changed, while the way to get there might be different, while there may be additional restrictions on how to operate, "profit" is still not considered a dirty word. Therefore, I think we can assume that companies would operate in the 1980's to maximize their profit (or maximize efficiency for mutual companies) just as they always should have been doing.

Maximization of profit calls for providing attractive products to the economy, at a cost competitive with other such products available, both insurance and other related products. As regards permanent life insurance, competition must be considered to exist with other forms of savings and retirement programs in addition to other forms of life insurance.

It is perhaps unfortunate that the insurance industry has focused its description of permanent life insurance as an investment medium. While perhaps at one time the existence of low prevailing interest rates made it possible to promote the "forced savings" concept without too much distortion (because interest earnings were not the major part of the illustration), that is no longer true.

Perhaps a better description of permanent life insurance would be one which highlights the guarantees as to premium levels and/or cash and loan values in the policy sold. In times of significant economic uncertainty, as illustrated by the three different scenarios, such guarantees may be thought to be valuable.

Current trends in product development are apparently based on the assumption that current conditions -- higher interest rates, higher inflation, improvements in mortality -- will continue. While this may not necessarily be a valid assumption, it is yet one that is apparently saleable.

Currently, anticipated inflation rates exceed long term interest rates, an indication of an unstable economy. Only when the investor feels comfortable that interest rates will exceed inflation will savings plans such as permanent life insurance become popular again.

During periods of relatively low and stable interest rates, decreasing and stable mortality, and low inflation, there was little difference between participating and nonparticipating products as to the investment element versus that of guarantee. Both afforded a reasonably attractive investment and guarantee element. Nonparticipating products offered slightly more of a guarantee while participating ones offered more of an investment, but the differences were not anticipated to be substantial.

We now have a period where there are significantly higher and less stable interest and inflation rates. The scenarios indicate that this pattern would be expected to continue. Mortality continues to decline, but we could see a reversal occur. During such a time, it seems logical to conclude that the participating products would be sold substantially as an investment product while nonparticipating would be more of a risk guarantee product.

Yet we have not seen this to be the case. Rather, we have begun to see the introduction of "hybrid" nonparticipating plans which offer a lower going in premium which can be increased or decreased based on future investment performance. We also see the shift of concentration of nonparticipating policies towards term insurance, thereby avoiding the question of investment guarantees altogether.

Why has this occurred? One possibility is that the current rating methods and profit objectives used in setting premiums for nonparticipating products need to be revised. The concept of contingency margins in rates is appropriate when the required margin for adverse deviation is small relative to the assumed level. Also, the concept that a company must anticipate a profit from every line of business in every year regardless of the circumstances seems to no longer be feasible.

Instead, it may be necessary for the actuary of a nonparticipating company to rate the entire company's portfolio -- term, permanent life, and annuities, and perhaps other non-insurance products, such that taken in toto, the block of business will be profitable. In effect, the company would be "immunizing" its portfolio of products via diversification.

The combination of annuities and insurance already provides a means by which the risk in mortality can be reduced -- if mortality deteriorates, annuities will provide the profit to offset insured life losses and vice versa. Of course, one can assume that persistency of the less favorable product to the insurer would be better than the persistency of the other product.

New designs in permanent life insurance will probably center around the means by which to accommodate inflation in both the benefit level and the premium level. This might also be accomplished directly using an assumed inflation rate or indirectly by changing the benefit based on the actual results of inflation experienced.

Life cycle and adjustable policies may be considered to be middle-of-the-road products which are not the least expensive products available but which provide the policyholder with the opportunity to change the balance between risk and investment as conditions (his own as well as the economy's) change.

The adjustable policies currently being offered, because of the fact that they are not directly price competitive with the corresponding traditional fixed products, will probably not be sold in large face amounts in most cases.

Automatic or semi-automatic cost of living increases in face amounts and, perhaps, premiums should gain popularity with the prospect that inflation will continue to erode indefinitely the value of the original face amount. An indexed monetary system would no doubt bring about the introduction of indexed products.

Of course, the new designs are currently limited by the regulatory environment in the requirements for policy provisions, as well as in nonforfeiture requirements which I will comment on later. Hopefully, in the light of the need for new products based on changing conditions, regulators would recognize the need for experimentation with new product designs by taking a flexible attitude on the application of current rules. In general, I think I have seen some indication of this willingness with the approval of life cycle and adjustable products.

MR. DICKSON: The high inflation scenario should be an ideal environment for deposit term particularly if the term rates are brought in line with competitive yearly renewable term. Presumably, regulatory and consumerist pressure will eliminate the more flagrant design and sales abuses; however, it will continue to be used primarily as a replacement vehicle. There's no reason why competitive YRT along with a high interest, single premium deferred annuity cannotbe used instead of deposit term as it now exists, except that the commissions might not be as attractive. Existing non-par business will come under extreme replacement pressure far beyond that seen during the 1970's.

Deposit term will lose much of its appeal in the incentive and investment scenario, since it will not be as easy to replace existing business without a continuation of substantial differences between "portfolio" returns on existing par business and "new money" returns on the "deposits". Existing non-par may still be quite vulnerable. Deposit term might remain viable in its own right if the term rates themselves were reduced to competitive levels. On the other hand, if existing business becomes less vulnerable to the "easy sale" (deceptive or otherwise) then it's likely the relatively low commissions will causemany of the deposit term specialists to lose interest.

The social democracy future shouldn't favor the continued growth of deposit term any more than the "good old days" scenario, and for most of the same reasons.

The least dramatic extension of conventional term and permanent products in the high inflation environment will be the widespread use of COLA benefits whereby the death benefit may be increased without evidence and within certain limits in response to Consumer Price Index (CPI) changes. Alternatively, the periodic increases might be predetermined at a fixed rate. Such increases can be easily accomplished through some sort of term rider and/or dividend option or can be an inherent part of the contract; in either case, premiums would eventually have to increase unless periodic death benefit increases were restricted to very modest amounts. As a practical matter, traditional level premium permanent designs will become increasingly unpopular as buyers effectively look to coordinate, at least roughly, both their protection and their premium outlay with inflation and their perceived ability to pay. Term plans will follow the same COLA approach which means even more rapidly escalating premiums at the older ages than with level face amount yearly renewable term. This will serve to retain a place for permanent plans where premiums increase but much more gradually.

Experience, to date, suggests a couple things about COLA coverages:

(1) If the benefit is optional and if the agent doesn't get paid something for adding it (as with dividend approaches) the usage will be low. However, in the face of long term inflation this will change as a result of buyer/competitive pressure, and agent incomes will be further squeezed.

(2) Buyers are quite receptive to "reasonable" increases in premium to pay for death benefit increases. Acceptance rates are high and company revenues and agent incomes are partially protected against inflation. Inflation-linked policies have been widely available in Europe for five years or so with rather spotty sales results.

The next step beyond CPI-linked conventional products would seem to be our old friend, variable life insurance (VLI), which I would expect to see reborn under this scenario. The main reason I say this is because I think buyers and agents will be more ready for it, especially if we build in more flexibility. But more importantly, I'm sure the companies will view it positively rather than ambivalently. Company thinking will reflect the cash flow squeeze and asset depreciation of the past year which shows no immediate sign of letting up. We can obviously adjust our investment strategies to a more liquid position but we can't change the reality of our liabilities with fixed dollar products. Variable life insurance (VLI) may offer some options for dealing with the policy loan issue also. If the companies condition, train, and pay the agent to sell it, I believe it can be successfully marketed. Conceptually, I'd see it following the New York Life approach rather than Equitable in order to keep the protection ratio high. Beyond that, however, I expect significant variations on the theme. Flexibility will be the key with:

(1) More choices of investment vehicles -- not just common stock but money market funds, bonds (governments might be linked), real estate, precious metals, baskets of currencies -- and limited transferability among the accounts.

(2) Choice of plan to allow graded premiums as well as level premiums, and

(3) Flexibility a la adjustable life.

It's my understanding that VLI in the United Kingdom has begun to catch on recently as a result of companies beginning to offer a real estate-based product.

Most of you are undoubtedly familiar with the Israeli approach to high inflation through a fully indexed economy, including life insurance. The key is the full indexing of government bond values and yields and the requirement that life companies invest their assets in such bonds. The result is a rate and value structure that varies directly with the CPI. Clearly, only a munificent and beneficent government can guarantee its securities in that fashion. It's interesting that sales of term insurance, which isn't indexed for reasons that escape me, represent only 40% of new sales in Israel.

Full cost disclosure might very well lead to "unbundling" of the permanent product. This might well lead to commission disclosure, level and/or negotiated commissions and the adoption of some sort of IYM pricing on the accumulation or savings element which would have to stand on its own. This would almost require agents to charge fees in addition to commissions. As consumers are increasingly squeezed by inflation they will become more concerned about protecting their standard of living, which in turn could further stimulate the market for financial planning services; an unbundled life product would seem quite compatible with such a development.

Rampant consumerism and tougher privacy laws sound like "bad news" for sensible underwriting. We may be forced to accept all comers at a specified rate with essentially no underwriting and permit those who are so inclined to voluntarily submit additional information in the hope of qualifying for a discount to what we today call "standard" or "preferred".

I'd expect to see many of the same developments in the incentive and investment scenario as in the high inflation scenario but at a slower rate and without full indexing. If the regulatory controls on banks and insurance companies are lifted we will presumably counter SBLI with our own counter-attack. While there are some logistical problems to overcome, trust services are a natural adjunct to life insurance. Despite the administrative headaches, we may see more money market funds and other savings vehicles, including policy cash values, with check-type withdrawal privileges via electronic funds transfer. Business financing for working capital, inventories, etc., might become a natural by-product of business insurance sales activity.

A healthy economy should spell rising personal incomes, more complex personal financial problems, and the need for financial planning which might well be supplied by life insurance companies. We have the distribution system in place and it's quite good at delivering the merchandise. Non-insurance-oriented financial planners generally push term insurance and they might set the tone in that fledgling industry.

MR. JOHN R. GARDNER: I cannot remember having had more difficulty organizing remarks for a presentation than I have had for this panel today. On the one hand, I find it difficult to dispute the arguments put forth by so many who suggest that, because of inflation, increased attention by regulators, and alternative mass methods of distribution, permanent life insurance distributed by full time agents will disappear from the scene. On the contrary, I am very much aware that for almost as long as the product has been in existence there have been those who have argued on one ground or another, but always with strong conviction, that the concept is on its way out. And if these mourners have in the past been premature, is there reason to believe that they will be right this time? And if it is too early to toll the bell for life insurance, what is it that enables the concept and its distribution system to survive?

There are some features of our business that do distinguish it from many other economic and commercial activities. In the first place, the product appeals to fundamental human emotions rather than to passing fancy. Under the social democracy scenario, the desire to accumulate capital in order to preserve one's family may be extinguished; under the high inflation and incentive and investment scenarios, however, the fundamental motivation that leads to the creation of a life insurance program will remain. The delivery of life insurance, as it is organized today, may not be the most efficient distribution system possible; but it is the only one so far available that satisfies the need. That fact in itself will make it very difficult to put life insurance down.

From a marketing viewpoint, the life insurance industry has an incredibly slow response time. The financial mechanics of the permanent life insurance policy lead to a mode of business conduct that tends not to have a sense of urgency. While the dramatic changes envisaged in the scenarios presented to us might generate immediate and drastic response by a firm in another industry, in the life insurance industry the response -- if any -- comes at a more measured pace. The crisis reaches its peak before the industry begins to respond effectively to the problem. By the time response is forthcoming, the crisis is past and another issue begins to pick up steam to take its place. The financial momentum of the business enables companies to sail by the crisis peak, if I may mix a metaphor, and on into other troubled waters. The slower, more deliberate reaction of the life industry enables the necessary changes to be made over longer periods of time, thereby gradually improving performance. So far, this general avenue of conduct has been successful. Will it continue to be so in the 1980's?

Another peculiar feature of the industry is its quasi-independent distribution system. Companies may predict what the future holds in store and may plot out the course of action they wish to take; the inability so far displayed to modify the distribution system quickly, however, may negate their efforts. The independent, entrepreneurial outlook of this distribution system has been the strength of the industry; in time of crisis, it could be its downfall.

I would like to talk for a few moments about the impact that sustained inflation has on the market for permanent life insurance, and on the agency distribution system. Under only one of the three scenarios does inflation take on dimensions that overshadow completely other forces. Under the other two scenarios inflation is brought under a degree of control that does not exist today. I believe, however, that the implications of heavy inflation for our industry are so grave that the subject deserves to be a focal point of this session.

When I refer to the spectre of inflation, I am not referring to the 7 to 7.5% inflation of the last decade, an inflation that in Canada pushed the salary rate for an agent's part-time secretary from $3,600 to $8,700 annually, or his monthly basic telephone bill from $15 to $30. The inflation that concerns me is the double digit inflation that will take that secretary's current $8,700 annual wage and push it up to $23,000 by the end of the decade, and the present $30 telephone bill up to $80 monthly. How will the industry, and more specifically, permanent life insurance, persevere in a climate that leads the consumer to expect his savings to be doubled over five years by large reputable financial institutions on a predetermined, guaranteed basis? What will happen in this environment?

Permanent cash value life insurance carries with it, by definition, the concept of a mechanism for advance funding. The buyer of a permanent life insurance policy is prepared to pay in advance for his policy more than the current cost for the death benefit in force. During an era such as is described in the high inflation scenario, an era in which prices double every five or six years, who will pay for anything in advance? The consumer will strive to obtain products and services on credit so that they can be paid for later with a debased currency. In such an environment the agent will find convincing a prospect to prepay a death benefit very difficult. In highly inflationary times, when financial responsibility is postponed as long as possible, the logic of one generation's providing for the next through life insurance will suffer. In product design, more and more policies will be sold that are built around step-rated term running to the end of the mortality table.

Let's look now at the problems created by high inflation from the insurer's viewpoint. How can an insurer provide the guarantees of financial performance that have customarily been the hallmark of permanent life insurance in a product designed to keep pace, step by step, with inflation? In designing such a product, how can the insurer combine advance funding of a benefit whose value keeps up with inflation, and still offer the same full guarantees of future financial performance? Design efforts so far have not found the answer. Linkage of benefit amounts with the performance of specific investment vehicles has not generated a product that is inflation-proof. Cost of living products have curtailed the extent to which benefits keep pace with inflation in order to preserve the guaranteed financial performance characteristics of the traditional product. The only products I have seen so far that are fully satisfactory from the point of view of matching benefits with inflation retreat from the concept of advance funding of benefits by requiring future premium adjustments.

How will this problem be solved in the 1980's assuming continued inflation? Perhaps investment vehicles will emerge that provide the necessary linkage with inflation. If they do, I suspect it will take a decade or two before they are sufficiently established to enable our industry's concept of a guarantee to be applied. Or perhaps the incorporation of guarantees into permanent life insurance will suffer and become less fundamental to the product design.

Now to another problem created by inflation. Let's assume for a moment that in spite of inflation the buyer would still like to fund in advance the benefits, and that the insurer has found a way of guaranteeing his product while agreeing to match inflation. In a double digit inflationary environment, where does the consumer get the money to pay his premiums? New purchases of life insurance will be sacrificed early in the game as the consumer fights to find ways of providing for today's necessities rather than benefits for the future.

Let's go one step further. Under the assumption that, in spite of heavy inflation, the buyer and the insurer are both able to co-exist with the concept of permanent life insurance, where does the agency distribution system as we know it today fit in? Checking on my own company to see where we are today relative to where we started the last decade, I found that in both Canada and the United States the sale of ordinary life insurance had grown at rates that were better than inflation. In fact, the growth of new business in Canada was close to double the inflation rate. First year premiums had also grown handsomely, but at rates that were closer to the cost of living climb and nowhere near as good as for the growth in new volume. First year commissions also climbed, at rates almost identical to those for first year premiums. At first I had a feeling of comfort. In spite of the shift from permanent insurance to term insurance, both insurers' revenues and agents' earnings were climbing as well as or better than the inflation index.

Knowing that our agency force had increased in numbers over the period, I asked how the picture would come out on a per-agent basis. The amount of insurance sold by each agent increased very nicely, at rates faster than the CPI. Commissions per agent, however, increased much more slowly than did the cost of living. And here lies the crux of what I believe to be a major industry problem: A sales force whose productivity has grown to keep pace with inflation or to surpass it, but whose earnings have fallen dramatically when expressed in terms of dollars with constant purchasing power.

The problem is even more severe than this analysis shows. In spite of the insurer's support, the agent must spend part of his gross commission earnings to generate business. While the typical agent's gross earnings have climbed more slowly than the cost of living, his out-of-pocket expenses -- car, postage, rent, secretarial help -- have climbed generally at the inflation rate. Study of net agent earnings would reveal just how far back the agent has slipped in terms of the purchasing power of his net income.

I dislike drawing conclusions from the figures of only one company. While some of the figures needed for a broader study are available publicly, others are not. Moreover, changes in the makeup of the agency force or a company's market can cloud the results. Certainly in Canada the changing role of the agency system in the savings business has an effect on the figures. In spite of these reservations, however, I feel the problem is real and will become much more pervasive in the 1980's, especially under the high inflation scenario. I would recommend that you look at the condition of your own agency forces.

The changing demographics of the 1980's will have definite impact on the marketing of life insurance and on the agency system. Some significant changes are:

(1) The rapid growth of the 25 to 44 year age group, as a proportion of the population (the coming of age of the post-war baby boom).

(2) Families with fewer kids and two incomes, but a shorter expected life span as a social unit.

(3) The expansion of the proportion of the population over 65.

(4) A five year increase in expected life span.

Let's see how these affect the distribution of life insurance.

The buildup of people in the population of what have traditionally been prime buying ages for insurance would in the past have brought a gleam to the eyes of an agency man. The growing existence of two incomes in the family, and especially the weakening commitment to marriage and family as a life-long relationship both work against life insurance, particularly permanent life insurance. Term insurance will increasingly be viewed as the appropriate product to buy.

At the other end of the spectrum we have a growing contingent of older people who are anticipating living to ages older than was previously the case. The abandonment of mandatory retirement may provide some income security. Other forces that have been afoot for several decades will continue to leave people feeling that they must face old age on their own. Of equal importance is the perception by younger people that this is the fate life has in store for them.

It appears to me, therefore, that the demand for accumulation-type products will grow strongly. Some of this demand will benefit the sale of permanent life insurance; other forces will call for a separating of the accumulation need from the insurance need. The result will be, however, a growth in the range and volume of products marketed by life insurance companies aimed at accumulating value and subsequently paying it out. These products will be structured with margins that are thin and company retentions that are very visible. Nevertheless, it is a business at which the industry is adept and can extend into easily.

Indeed, there could be a reasonably good pairing between the agency force of the 1980's and this "graying" market. My net impression of the scenarios offered is that the agency system will not grow in numbers of people, and may well shrink as a result of financial pressures on recruiting efforts. The agency forces will, therefore, gradually age in the same way as the population. Agents, as they have become older, have tended to shift from selling to a newer generation and concentrated on the servicing of existing clients. In the 1980's this existing clientele could be a greater source of new business -- accumulation and annuity products -- than it ever has been in the past.

Mind you, the marketing approach will have a different emphasis from that of the 1970's. This time the shift to accumulation products will be accompanied by the realization that they cannot substitute for permanent life insurance as a source of sales compensation. If one is to sell in this market, one must either sell a great deal more premium or accept smaller earnings. In the 1980's, it will be recognized as an extension of the agent's original business.

MR. KOPPEL: The traditional general agency system of compensation and distribution is probably best suited to the high premium and high face amount cases which can absorb the extra expense required for a personalized sale. In fact, where there are high premiums and face amounts involved, it is not illogical to assume that the involvement of an agent to tailor-make a plan which fits the prospects' needs can result in long term cost savings by avoiding the need for replacement and the associated increased expenses. This fact will undoubtedly be intensified under any of the scenarios.

However, for smaller sized policies and sales to lower and middle income consumers, "shelf" products, adjustable or otherwise, which can be sold in a manner which produce higher volume per person selling seems appropriate. Use of other means of distribution for smaller size policies such as through direct response, mass merchandising, and department store sales, and use of less stringent and less costly underwriting standards, both of which keep related acquisition cost levels to manageable levels would also seem logical.

In any event, in light of pricing and profit considerations, companies will need to closely examine their hiring standards of agents. The cost of financing agents who do not produce sufficient levels of business must reflect itself in the price of the products sold.

At the same time, it might be possible to reduce the costs of financing new agents by reducing turnover -- chiefly through using better techniques of selecting fewer agents but ones who have the ability to make it as personal salespeople.

The current Standard Nonforfeiture Law and its anticipated revision have the effect of limiting product innovations. Because of the requirement of minimum levels of cash values, companies are precluded to some degree from offering lower premium, lower cash value policies which may be better suited to a prospective buyer's needs. Again, non-participating permanent products are more seriously affected by the existence of these requirements in that the result is that the premiums for non-participating policies are kept to a level nearer to those for a participating policy. By relating the minimum cash value to the pattern of premiums and benefits rather than to the level of premiums and benefits, the Standard Nonforfeiture Law does not credit lower premium products by permitting lower levels of cash value.

Certainly there is some logic to relating the required level of nonforfeiture benefit to the levels of the premium and the death benefit instead of relating it to the premium and benefit patterns. By being able to offer lower cash values, presumably the premium can be lowered as well. The fully informed purchaser should have the option to select a lower cash value and lower premium plan. There is literature which suggests, and people who believe, that the cash value on a policy should be set as a minimum at the level of the asset share. I do not happen to agree with this theory, given an informed purchaser. However, even this theory would permit a lower cash value level for policies with lower premium levels.

The Standard Valuation Law must provide for the means for updating both mortality and interest bases in order for non-participating permanent plans to have the ability to be offered without requiring deficiency reserves. An NAIC subcommittee is currently considering the means by which to adopt a dynamic approach to the Standard Valuation Law.

The existence of requirements for policy loans to be offered at maximum interest rate levels can be thought to be a blessing or a curse. Companies have apparently been reluctant to take advantage of the opportunity to publicize the significant benefit to policyholders of the 5% and 6% loan rate in their older policies because of the fear that such publicity will precipitate an even higher volume of additional requests. If they did, they could also publicize the current policies with 8% loan rates which would also be considered attractive to prospective new policyholders based on prevailing rates and based on the three scenarios.

Again, perhaps it would be a good idea to permit companies to market two forms of the same product -- one which permits unrestricted policy loans with unrestricted maximum interest rates, the other not. Perhaps a policy could have a provision which ties the nonforfeiture rate credited to the cash value to the level of the loan outstanding on the policy. This type of provision should be readily understood by the consumer in light of provisions currently marketed by savings and loan associations and banks in certificates of deposit.

Another possibility would be to permit the interest rate in the Standard Nonforfeiture Law to be tied, within limits, to the maximum loan interest rate. This type of provision again would permit the informed consumer to make an intelligent decision as between the opportunity to obtain a more favorable loan provision at a higher premium (and higher cash value) or a less favorable provision with lower scales of premium and cash values.

With regard to the income taxes, the existence of anomalies in the tax law relative to the true earnings of the company will cause a concentration of companies' efforts toward areas which minimize taxes and away from areas which tend to increase them.

In this regard, the 10 for 1 rule in the 1959 tax law, which was shown to be valid when enacted for a small range of interest rates, is not valid under conditions of higher interest rates. Of course, if, as in the incentive and investment scenario, the corporate income tax is eliminated, if this applies to life insurance companies, the anomaly of the 10 for 1 rule would also be eliminated.

As to taxation of policyholders, there has never been a totally satisfactory permanent life insurance product developed which can be used for funding employee retirement benefits and also provide full tax relief benefits to both the employer and employee. A change in the tax law which gives more favorable treatment to the cash value and interest accumulations in permanent policies used to fund retirement benefits would obviously help the sale of such policies. This would most likely occur under the incentive and investment scenario.

MR. GARDNER: The outlines for all three scenarios set forth lengthy expositions of what the 1980's hold in store in the regulatory arena. No matter which way economic performance and social values move, regulatory activity will change, and the degree to which the industry is open to the public increases. The regulator can be expected to involve himself more and more in the marketing of life insurance. Cost disclosure was established in the 1970's and will continue to impact on the business. As long as the process insists on breaking the permanent insurance product down into pieces to be appraised separately, it will always appear in an unfavorable light. Somehow the sum of the pieces never seems to stand up as strongly as does the whole. When the disclosure process looks at savings performance, be it long term or short term, it does not look that impressive. The role played with respect to early death claims and income settlements at current annuity purchase rates, however, always seem to be lost from sight. And how does one put a price tag on the assistance of an agent, or on the convenience of having so many financial arrangements wrapped up in one product?

Pricing pressures brought about by disclosure requirements, by increased competition for a static or declining market, and by the squeeze of inflation will see companies spending less money on their agency systems and looking for alternative distribution channels. Certainly it will be the exceptional company that starts up a controlled agency force. Opportunities for distributing combination savings and insurance plans will exist through employer and union groups: Insurance companies will find that by adding a thrift or savings plan to their group term life business, they can generate the same premium revenues at less cost.

Attention directed by outsiders to selling expenses and to commissions in particular could during the course of the next decade have an interesting result on the relationship of the agent to the marketing process. Pressure on commissions could lead to the agent's charging the client directly for services rendered. This step would require rationalization of the agent/consultant dichotomy and changes in the laws and regulations governing the sale of life insurance. In an environment that is heavily disclosure-oriented, selling expenses that are very visible should not be established by the life company's formula alone, but by what the buyer finds satisfactory for the services rendered.

Another inherent inconsistency in the delivery of life insurance that I expect will rear up for resolution in at least two of the scenarios is the balance between sales and service. The public image the companies present is that of a service industry structured to provide a continuing relationship with its clients and to deliver a mixture of financial and counseling services when the event insured against occurs. While in theory the commitments can be honored, and the great majority of established agents take deserved pride in the service they render to the bulk of their clientele, in practice the industry is vulnerable to continued criticism. The 1980's will not let companies concentrate on short-term production objectives at the expense of follow-up service, especially as revealed through high lapse rates. Nor will companies be allowed to protect the commission rights of selling agents on business sold to a clientele that has moved to a far distant location.

I believe that the life companies will not find it too difficult to live up to their service responsibilities in the 1980's, as they find they can take up much of the service burden from the agent on a basis that is satisfactory to all concerned. Systems involving a variety of media will be developed. The insurer will determine that he can deliver consistent service to all policyholders while freeing up more of the agent's time for selling. The cost of the company of delivering this service will be less than that of the opportunity previously lost through denied selling time.

The continued development of the risk classification argument will most likely lead the industry further toward a condition in which its ability to classify risks and charge accordingly is, if I may use the expression, impaired. Under this scenario, it is not clear to me what role the agent will have. If one is no longer allowed to classify risks on the basis of medical condition, economic situation and general physical appearance, much of the field underwriting role of the agent could well disappear. At least as we know that role today.

It could be that the pool of risks generated by an individual agent that becomes the unit for pricing purposes. The agent would have to manage his book of business to achieve the targeted experience; alternatively, if the regulatory framework were to allow it, pricing differentials could relate to the business of individual distribution centers.

Another outcome would result if price competition was allowed between carriers in an insurance industry that was close to devoid of risk classification. Under these circumstances, the business would be made up of a number of insurance pools, each with an undifferentiated rate structure, reflecting its own experience. The tendency for agents to become brokers, acting on behalf of the consumer and helping him seek out the cheapest pool, could become strong.

The changes recommended to the NAIC by the American Council of Life Insurance, changes whose basic premises I believe the NAIC still favors, will lead to lower premium rate structures. The new mortality table will generate lower adjusted and net premiums, and, most likely but indirectly, lower gross premiums. Similarly the higher interest rates to be allowed will move premium structures downward. Even the proposed changes in the expense allowances -- a higher percentage of premium and a lower constant -- will tend to push premium rates down for younger people.

Lower premium rates will naturally make the product more attractive to potential buyers. Lower premium rates, however, will also reduce the margins for both the insurance companies and the agents, thereby reducing the availability of the product in the marketplace.

As significant for the future of permanent life insurance in the 1980's as the changes currently proposed are the changes that are not being made. The regulations after revision will still require life insurance contracts to guarantee in the policy the actual dollar amount of cash value and other nonforfeiture benefits that will be available long into the future. The proper strategic response to a world which gives rise to scenarios as widely varied as those presented to this meeting is to choose a course of action that leaves one with as many options open as possible. Not so with the nonforfeiture law. One must detail down to the finest point exactly what one will do for the next century. The concept of fully guaranteed nonforfeiture values goes back almost 100 years. Since the time that this approach became enshrined in our product, life spans have lengthened and the rate at which social and economic changes occur have accelerated. The industry is, therefore, extending the length of time over which it provides guarantees in an environment that is becoming more and more unpredictable every decade.

Until the nonforfeiture law permits companies more flexibility with respect to surrender and nonforfeiture benefits contained in permanent life insurance policies, the industry will be hamstrung in its efforts to respond to changing futures. Why is it not possible for a life insurance contract to be sold which at the most guarantees the method with which values will be determined in the future, while leaving unstated the actual parameters that will be employed in determining those values, should the need for them arise?

A separate but related issue has to do with policy loans. If double digit inflation perseveres into the future, will not contracts providing the right to borrow against permanent life insurance values at interest rates that are ridiculously low by today's standards go a long way toward killing the concept of permanent life insurance? Companies will operate today's distribution system with today's expense patterns, but with no advance death benefit funding and no buildup of reserves.

A Canadian approach to policy loan interest rates permits the establishment of rates that are realistic and permits rates to be varied in the future according to economic conditions. The two merits of this approach are the directness with which it fosters equity and the enabling of rational business decisionsfor life companies in the area of policy loans.

MR. DICKSON: In the high inflation scenario traditional non-par term insurance will continue to be sold during the 1980's although it may come under somewhat greater pressure due to the expectation of significant mortality improvement which it may not make sense to project into the indefinite future. I would expect par coverages to be very aggressively priced given the environment and competitive pressure. It's quite likely that non-par term will be offered at a discount from a guaranteed premium ceiling as is already being done with permanent. The old days of very attractive non-par term combined with non-competitive permanent plans will become a thing of the past, at least in the large case market. The term will have to stand on its own because more buyers will buy it for the long haul and when it is converted, presumably it will be to a less profitable, more competitive non-par product, probably of the "indeterminant premium" or discount variety.

I don't see any way that traditional non-par permanent pricing can accommodate both the legitimate profit concerns of stockholders and, at the same time, the competitive demands of the marketplace in an extended inflationary environment. Assuming favorable persistency, how far can the stock company actuary go in projecting current high interest rates over 20, 30 or more years? How much longer can recent rates of mortality improvement be anticipated before the cumulative effects of environmental pollution in its many insidious forms halts that trend? How will the cost of administering business in force vary over the next 20 years in the face of regulation, inflation and replacement pressure? My own feeling is that common sense and pressure from the marketing side will force stock companies to follow the lead of Aetna and Travelers with their flexi-premium approach. Higher reserve interest rates (e.g., 4½%) and nonforfeiture rates (e.g., 5½%) will be incorporated in these designs. It may well be that the key to more widespread use of the non-guaranteed discount approach on permanent depends on the IRS. Will they end up treating such discounts as dividends or as premium reductions which are deductible from the gain from operation? As an aside, I see considerable potential for buyer misunderstanding of the link implied in advertising I've seen between interest rate changes and gross premium changes. (What interest rate changes? Prime rate? AAA bonds? Over what period of time?) In addition, a premium reduction further squeezes agent incomes although this can probably be justified by the improved cost performance.

I suspect that multi-line companies will continue to put what pressure they can on property and casualty brokers to sell their life products as the quid pro quo for writing automobile, homeowner, etc. I don't see that as being particularly effective and might even be prohibited by the regulators. Some companies could be forced to withdraw from the traditional individual business in favor of some variation of mass merchandising. For example, guaranteed issue, life insurance on an employee-pay-all (or most) basis might be sold using salaried enrollers and this would probably be offered with auto and homeowners; the life portion could be true ordinary, group permanent or group term. The point is that it will become increasingly difficult for professional career agents and brokers to compete with quality par coverage using full commission non-par plans. Therefore, other distribution methods, including direct mail, will be tested more seriously.

As a practical matter, I'd expect to see less and less emphasis on individual life and more and more on annuities, investment products, and pensions where the stock companies have been quite competitive.

I'd expect "business as usual" in the growth oriented, healthier economic environment of the incentive and investment scenario. Changes would come more slowly. But, with the experience of the late 1970's, I still see the gradual adoption of the flexi-premium approach to permanent insurance. While short run "survival" of individual life operations might not be at stake, it strikes me that stock company management would not want to be caught in a late 1970-type squeeze during some future high inflation period; agents and brokers will also keep the heat on for more competitive products.

The social democracy scenario could be a relatively favorable one for non-par, even though there will be a rather limited life market due to government welfare benefits. Less attention to life insurance and more to supplementing public pension benefits will probably be indicated. Ways will be sought to mass market most products through rejuvenated and powerful unions.

Returning to the high inflation scenario, for all the reasons and in all the ways mentioned previously, existing non-par business will be replaced in wholesale quantities in the absence of some response by the stock companies.

But, what sort of response is practical? Would it be proper or wise to allocate a significant amount of past or present stockholder profits to improve the performance of such business? Is it financially feasible to try to improve the performance enough to significantly reduce replacement activity? I don't see a reassuring answer to any of those questions. As usual, replacement activity will be doubly damaging in that mature, profitable business going off the books reduces profits, whereas, recently issued business that is replaced never has the chance to generate profits. Much of what stays in force will be small, marginally profitable business or impaired risks who may develop unexpectedly high mortality costs.

The traditional "replacement-is-generally-not-in-the-policyowners'-best-interest" viewpoint will virtually disappear. Regulators and consumerists may well encourage such a development subject to appropriate disclosure and suitability guidelines.

Depending on their Federal income tax situation, some stock companies might follow Northwestern Mutual Life with their reserve conversion program. It would cost them relatively little, they could gain some positive public relations, and might help combat replacement pressure. Specifically, those companies that expect to remain in a Phase I Federal income tax position could offer to convert to higher interest reserves using the tax savings to improve policy performance. Alternatively an original age conversion to a new discounted premium plan might be offered for the same premium and larger face amount. Perhaps at the same time a swtich to an 8% policy loan rate might also be offered to further improve performance. Any such improvement in performance could be passed through in the form of lower premiums, higher death benefits, or both. It should be acknowledged that this could be a major undertaking and not worth considering unless significant policy cost reductions could be realized. Obviously, if any "gratis" extra-contractual reduction in cost were being considered, these other changes could further sweeten the deal. If such changes don't make sense on an across-the-board basis, internal replacements will pick off larger policies, if pricing of new policies is more competitive. This practice could be encouraged in lieu of a reserve conversion by granting full or modified new business commission and production credits and eliminating any unusual penalties. Some companies might even develop their own replacement vehicles for use on their largest policies in force rather than see them switch to other companies. This sort of approach is already being used to conserve individual annuities.

Replacement pressure will be less in the incentive and investment scenario, but still significant. The limited counter-moves available to improve the performance of existing business could be more helpful in this situation since the problem would not be as acute in the first place.

As far as the social democracy scenario, maybe the best bet would be to lobby for government protection. With most agents unionized, strong union political pressure might be marshalled, since most agents would continue to resist replacements for philosophical and financial reasons.

MR. JAMES F. REISKYTL: Spencer, you said last night that you had an answer to this non-par situation, that you have developed an adjustable policy that permits the old non-par purchasers to move over to the current basis. Can you elaborate on that for us?

MR. KOPPEL: Well, that's not entirely correct. I'm sorry if I gave you the wrong impression. It permits our existing policyholders to add additional coverage on the current basis, keeping the original coverage at the older basis. We have the facility which you're describing, and we have talked about that as a possibility if conditions warranted -- just as any non-par company has that facility with its traditional products -- but we have not made any massive effort to do that. We have the same questions in our mind as any non-par company does: Is it appropriate, or is it feasible to take your existing block of business, which is providing some profits which generate surplus to generate new business, and change that profitability to the new rate? If it's in danger of being replaced, it's one of the things that one has to do. But the business isn't that old. We only started writing this business in 1966, so it's not like we're talking about 30 and 40 year old policies. So at this point in time we haven't made any substantial effort to change the basis on existing business.

MR. LOUIS WEINSTEIN: This question is directed to Mr. Koppel. Approximately 10 or 12 years ago a member of our profession stood on a panel and indicated that he was very unhappy that he didn't have the option to purchase a permanent whole life policy without nonforfeiture values. He felt that in the spirit of consumerism, as an informed consumer, he should have the right to buy such a policy and pay a lower premium. This comment was made today. Would you suggest that we extend the suicide provision from 2 years to 20 years and reduce the premiums still further, that we extend the incontestability period from 2 years to 15 years and cause another price reduction, and eliminate the settlement options and the reinstatement provisions and come down another nickel or dime? In short, these suggestions sound like something very similar to what we read recently about General Motors putting Chevy engines in Oldsmobile cars. And it occurs to me that under the scenarios we have heard, Chrysler and Ford have gone bankrupt and General Motors is the only surviving manufacturer of automobiles. So maybe you and he have the right idea, and I have the wrong idea. But somehow it didn't sound right then, and it doesn't sound right now.

MR. KOPPEL: Okay, I'll put on my radical hat and agree that there is nothing wrong with General Motors putting Chevy engines in Oldsmobile cars, if they disclose that that's what they're doing and if they can provide such a car at a lower cost than by putting Oldsmobile engines in Oldsmobile cars. Now there is a market force. And if elimination of settlement options only eliminates two cents per thousand of premium on a policy, then probably the company wouldn't find it worthwhile to eliminate settlement options. But if there was a significant reduction in the premium associated with it, provided the consumer is given the information as to what he is buying, I think the company should be able to provide a policy without a settlement option. You get into suicide provisions and you get into the question of public policy. It's sort of a gray area there, but excluding the concepts of public policy, I see nothing wrong with providing different benefits at different prices.

MR. REISKYTL: You said there's nothing wrong with providing a contract with cash values that are less than the asset shares. Suppose you had this freedom. What difference in premium would you be talking about?

MR. KOPPEL: While I've not done any calculations, I guess I would always want to offer both if at all possible; that is, one product with strong guarantees at a higher premium and another product with lower guarantees at a lower premium. I understand, for example, that Occidental's Canadian branch or subsidiary -- I'm not sure which -- is offering a term to age 100 product with no cash values, which is whole life without cash values, and I understand the premium is about 25% or 30% lower than their whole life product with cash values. But I haven't done any analyses other than that.

MR. GARDNER: In terms of breaking permanent life insurance up into a sort of do-it-yourself or build-your-own whole life policy parallel to the cafeteria approach for group benefits, one of the things that I can see happening in the 1980's -- and it will come about as an indirect result of the disclosure activity -- is that the amount of money that is tied up in life insurance premiums for putting business in force will become evident. The question will be asked why not, under certain circumstances, leave the amount of compensation to be settled between the agent and the buyer? I can see whole life policies being sold on a commission or a commission-free basis. The commission-free basis, obviously, will be outside the contract in a separate arrangement between the salesperson and the buyer of the product. You may well find companies scrambling to try to find new ways of distinguishing themselves, which really is the whole name of the marketing game. How do you show that you've got something that other people don't have? And I suspect that you may see some products on the market which are proclaimed as commission-free.

MR. REISKYTL: Earlier, I believe John said that he felt that either guarantees in the high inflation scenario weren't appropriate or, perhaps, they weren't desired. Kim, what's your feeling about the need for guarantees in our products in the future?

MR. DICKSON: There are still an awful lot of buyers for whom guarantees are of some importance. The kind of environment that we've lived through recently just makes it all the more so. One of the more significant factors is the extent to which guarantees are very important to our field organization. We've impressed them on the importance of guarantees and, for a variety of reasons, many of them totally espouse that kind of thinking. As far as I'm concerned, they definitely do have a place. But as I indicated, there are some reasons why, given the continuation of high inflation, buyers, field organizations and companies may very well begin to do some more serious experimenting away from guarantees. The very serious financial problems that we face right now are a direct result of the fact that we're trying to guarantee our contract values. Yes, there's a place and I think it will take time to change attitudes, but there are some reasons why we may have to if things continue as they have.

I'd like to toss out a question for the floor that has to do with some of the comments I was making about the replacement vulnerability of existing non-par business. Specifically, what are some of the companies trying to do to deal with that problem and what do you think will be required over another two or three years if the situation that we have faced continues?

MR. RICHARD S. MILLER: I was asked a similar question by my president a few weeks back and did some research on our 1958 issues of $100,000 or more of whole life. I came to the conclusion that on that block of policies we had absolutely no exposure to any additional replacement problem, since it was 93% loaned out. I then went into the $50,000-$100,000 category, and not quite so dramatic a result took place. I also did a lapse study on all of our business in force post-10 years duration and compared them with some previous lapse studies. The result of all this is that it appears that the prime durations are between 7 and 14 years. After 20 years, our lapse rates have not deteriorated significantly in the last 15 years. By significantly, I mean they have moved from 1.6% to 1.7%. But in the 7 to 15 year area, where previously we have had lapse rates dropping rapidly into the 2% area, we now do not get to 2% until we get out into the early teens. Now this suggests to me that there is more activity on the part of the agents than there is on the part of the policyholders. And to the extent that we can keep the agents busy selling new policyholders and satisfied with the living they can make, I think we can live with the replacement situation.

MR. DICKSON: Should I infer from your comments about loans that business that's 3, 4 or 5 years old, that might not have an awful lot of loan value anyway, isn't particularly vulnerable to some of the very competitive participating plans that are out? You are saying that if your loans are all out, it's no problem. But I wonder if it's necessarily that simple.

MR. R. MILLER: A policy that's fully loaned has certain tax advantages that have then played up perhaps beyond their true worth, at least in the minds of the policyholders. The habits have grown quite strong.

MR. DICKSON: You can always do that again with a new contract.

MR. R. MILLER: Not for 4 years, and you also have reportable income if you cash out the old policy.

MR. GARDNER: In terms of the work you've done, is the fact that you have to wait for 15 years before the lapse rates get down to that very low level a characteristic of the length of time the policy is in force, or is it the changing attitudes of the buyers? In other words, the buyers in the 50's or in the very early 60's bought their life insurance under one set of motivations, and subsequent transactions with their insurer have built up one attitude toward the product. But people who have bought differently have had a different outlook as to what their permanent life insurance is for, created at the time of sale and by subsequent interplay with life insurance agents.

MR. R. MILLER: I think that the fact that the lapse rates do eventually get back down to the same level as the older generations of policyholders have exhibited may lend weight to an assumption that it's the natural level that they will achieve under a good sale and reasonable service. The more recent generations might be in complete discontinuity with the past. If so, all actuaries are in for good times as we try to explain how we mispriced these products.

MR. REISKYTL: Let's go back to agents' compensation and agency system for a moment. Drucker made the comment that people are too expensive to use for selling. If you can't sell anymore, you must market. We must create a desire to buy which can be satisfied without the agent doing a great deal of selling. Is the agency system going to survive high inflation? Will it survive in the social democracy scenario? Presumably it will in the incentive and investment scenario.

MR. GARDNER: I both agree and disagree with Drucker. The statement that you're referring to is that people are too expensive to have them engage in the selling process. I certainly think that that will show up in the 1980's. As disclosure of financial performance of the life insurance companies increases, it will become apparent how much of their operating expenses are tied up in the maintenance and service of existing business.

The skill for which the agent is hired and the skill for which they keep him is his ability to sell -- not his ability to service. The insurance companies will find that they can develop systems, they can use a variety of media -- telephones, mail, personal visits -- to provide the service. They will develop these systems in a way that does not antagonize the agent. And the companies will benefit because the service responsibility will be better handled and it will be done on a more cost-efficient basis. The agent will be happy because it will get that particular monkey off his back, and he will have more time for selling and, perhaps, we will see the number of sales per week increase. If you free up some of the agent's time so you pick up his back-in-the-office work and his post-sale work, the agent can spend more time in the selling process. That's another way of optimizing the use of the resources tied up in this industry.

MR. DICKSON: I would generally agree with John's comments. I seems to me that the companies that are oriented to the middle income market, though, if in fact we had continued double digit inflation, would have a devil of a time trying to keep up with what happens in the way of the squeeze that was referred to earlier. I would have some serious doubts about productivity being able to increase rapidly enough or selection and retention being able to improve rapidly enough. If you are oriented to that middle income market, there's going to be a real problem if there are two or three years of double digit inflation. Whether it's 10% or 20% obviously makes a difference but it's really going to be tough to live with. In the higher income markets there may be a better shot at it, particularly if as it so often happens in inflationary periods, the upper income buyers tend to stay closer to whole with respect to inflation than do lower income buyers. Productivity is going to be the key as to whether the field organizations can survive. It may be an awfully expensive way to get the product distributed, but it's about the best one we've found so far, and I don't think it's going to go down the tube just yet.

MR. REISKYTL: How are we going to improve productivity? Will it include some kind of electronic support? What other thoughts do you have concerning the need to be more productive? Do you increase just one or two sales per week or something greater? Any thought in that direction?

MR. DICKSON: Certainly, the market to which we orient our agents and the support we provide them will be important. Agents are going to have to sell clusters of people, whether that's in a mass merchandising sense -- relatively small amounts but lots of them with very little time spent -- or whether it's the large corporate sale that may involve ten executives with very large amounts that may take a very long time to develop. Another way is to get the agency force reoriented to the fact that 30 cases a year, or 35 or 40, is just simply not enough. They know this. They maybe don't put 2 and 2 together in some cases, but they see the bottom line. What we've got to do now is start moving those expectations up. This starts with training. With the experienced people I think it's tougher. It's a manager's job to work on those people.

I'm not necessarily sure that a lot of money on electronic support is the answer. We've spent a lot of money in that area already.

MR. GARDNER: This is the kind of question where the format for this two-day meeting breaks down. The same question was probably asked in the start of the 70's and 60's and the 50's, and the same kind of obvious answers are put forward, and I don't think we've found ways to making them work well enough. And I don't think we're generally in any better position today, unfortunately.

MR. KOPPEL: I don't think that support of any kind -- training, data processing, whatever -- can change the fundamental fact that the total agency force is only going to sell a certain amount of policies per week, given that we select the same agents that we do now. The only way to improve productivity is by hiring fewer agents, selecting those who are more likely to succeed, and giving them a market that's somewhat different than the market as they see it today. I think you're right that the selling costs are too high for the middle-income, middle-sized policies. They are only acceptable and appropriate in the larger policies where tailor-making the product is appropriate and the cost of selling that policy can be absorbed in a higher premium associated with those policies.

MR. WALTER N. MILLER: Many of us would agree that the agents themselves, these days, facing these pressures, are exercising a high degree of self-selection. You see this at both ends of the scale. At the lower end of the scale, where everybody for various reasons increasingly wonders whether the traditional agency system is an economically viable way of marketing insurance, a lot of agents are exercising self-selection. They're selecting out. You can call it failure or you can call it an intelligent decision that the agent realizes he can't operate this way in this market and he'd better try something else. The other place we see it, at least in my company, is at the upper end. The biggest pressure that we at the New York Life are receiving from the field is to develop new and better mass marketing programs and methods -- from our layer of most successful agents. Because they also recognize that the way they operate, the way they feel they have to operate, with their hopes and expectations for the future, they can't afford a lot of time selling $25,000 policies. Isn't it amazing that you have to think of a $25,000 policy as a small policy? But it's true.

The other related observation is that we've been hearing a lot of talk about two institutions that are involved. We've been hearing talk about companies, and we've been hearing talk about the agents. There is one other institution that is intimately involved in this whole process, and that is field management. If you want to talk about areas where people are worried, where they're resistent, where people are saying, "Well, that really sounds okay, but I'm not so sure. . .", it is probably in our field management. Because many of them are pretty effective people. And they're smart enough to realize that when you talk about vertical growth in the field force, increasing selection standards for agents, and things of that nature, you're really talking about significantly cutting down the numbers so you can increase the productivity of field management in the future. They are an important part of the equation.

MR. GARDNER: I would agree with you. There's more mileage to be made by a company not by working directly on the agent and not from the home office end, but by improving the skills of the company's management in the field. There are more yards that are going to made there in the 1980's by those companies that survive than anywhere else.

MS. ANNA M. RAPPAPORT: I'd like to bring a little different perspective to some of these questions. I'm a consultant. I work mostly with employers and also have had a lot of experience in the life insurance business. Employers are significant buyers of permanent life insurance products; many of your larger sales are to businesses. These same businesses have been accustomed to having some choices in the employee benefits area that they may look for in individual products in the future. One choice is whether we should pay for the services of the person who brings us the product by fees versus commissions.

Much group insurance now is sold with fees rather than commissions. A second choice is how much guarantee we want. These employers have become used to taking significant risks in their employee benefit programs, and for an employer that's done it, having a product that's more attractively priced but with less guarantee could be completely consistent with his philosophy. So I would submit that there will be opportunities for those of you who are willing to experiment and offer employers some choices compatible with the choices that you're now offering for group benefits.

MR. DICKSON: At least with respect to the first part of that, I think it's already here. Some of the large brokerage houses that we'd like to do business with are increasingly talking about very low commission structures. Obviously, the extreme of that is zero, but with fees that they would tack on. The individual who's going to make that decision in the corporation can't quite conceive of a commission of half a million dollars, for example. We've had some fairly serious conversations about what you can do to either spread out the commission or eliminate it entirely. This sort of discussion will certainly continue. As far as the guarantee side of it, I suppose there are many ways you can go with that. I don't know if you had something specific in mind there or not. Variable life would certainly be one way to get away from guarantees or maybe something more along the lines of what Spencer was describing. But I don't think that they would want you to get rid of the cash value entirely.

MR. GARDNER: Perhaps I can comment on the guarantee side of it. I believe that the existence of the guarantee concept, so thoroughly worked into the individual life insurance business, is imposed by the industry itself. The guarantees are not built into it because the consumer has insisted on them in the past; they're built in because that's the way we've structured our industry. You asked the question earlier, Jim, what we'd do if we had freedom. I think it could be a very challenging couple of decades coming up for those companies that say, "Well, let's play around and see what we can do in the way of providing our service, but on a basis that doesn't have such strong guarantees or perhaps doesn't have any guarantees at all." They have to be careful that one of the guarantees that they take out is not that the money will be paid when the insured event happens. I don't think that's what they are looking to remove. It's the financial construction of the product that does not need to be heavily guaranteed.

MR. REISKYTL: We took part in a Stanford Research Institute study, which was done, granted, before the double digit inflation of today. But one of the factors that came out of it, and came home strongly to us, was that one of the prime things that higher level paid people, salaried or otherwise, were looking for was a guarantee. They weren't even as interested in what the return was; they had become very market-conscious as to "Will I have a dollar and not 50¢ or 60¢?" So this may be another side, and I suspect there will be a market for both in this unknown future environment.

Let me raise one other question concerning the distribution system. It was suggested at least by one company that the way to go in the future is to establish large general agencies, like clinics, that offer a wide range of financial products and services. There would be financial counselors -- our agents would become financial planners -- and they would have support from various fields and would sell multiple lines. It would be like a medical clinic only it would be an insurance or a legal clinic. Do you see this evolving in one of these scenarios?

MR. DICKSON: I don't know why it couldn't. We've got a few agencies that are very heavily oriented to the upper income market with sophisticated estate planning, and so on. We've got lawyers and we've got one case of a CPA. But if you begin to bring these kinds of people in it means a lot of overhead and you better be generating some pretty good revenues. I don't see why it can't happen, as a practical matter, but it's going to certainly be an exception.

MR. GARDNER: On a less formal basis, many individual agents, especially in urban areas, have done this. They've worked up partnerships with people who have recognized skills in other professions, and they've been doing this for years now.

MR. KOPPEL: I would assume that this is being done in the small-employer market for the key people within a small group case. I think there are such things that exist, not necessarily called general agencies, but professional agents who are marketing this kind of a program for small employers.

MR. REISKYTL: Spencer, you had suggested during your comments that the par product would be more of an investment product and the non-par product more of a guaranteed product. That surprised me a little. Will you expand a little as to how you see that distinction?

MR. KOPPEL: I'm presuming that the non-par product can have a sufficiently low scale of cash values to provide, for a lower premium, a guaranteed death benefit without the question as to whether it can go higher or lower. The participating product would have, then, a higher premium which is supposedly invested. It provides for the investment but not much guarantee, since the dividend rate is not guaranteed for the life of the contract. Assuming something terrible happens, such as lower interest rates, higher inflation, or a reversal in the mortality trend, the participating policyholder is the one who doesn't have the guarantee.

MR. REISKYTL: In the area of regulation, actuaries in Canada tend to have greater freedom than those in the United States, and we've talked a lot about what we might do if we had complete freedom. Would anyone wish to comment on regulation and what impact it's having? For instance, the lack of uniformity among the states is becoming more difficult, more expensive to comply with. Canada apparently doesn't have these problems, at least not to the same degree. Would someone wish to comment in this area?

MR. DICKSON: John, doesn't most of your Canadian business in force have an 11% permitted loan rate? You're charging 9%, and you could be going with 15% or 16% on new business? Is that somewhere near accurate?

MR. GARDNER: I've been out of touch with our activity in Canada on the ordinary side for awhile now, so I'm not completely familiar with all the specific details. There might be someone else who can answer more precisely than I can. But there's still a great deal of business in Canada that's in force with guaranteed loan interest rates, just as it is here in the United States, and it's posing exactly the same problems to companies in Canada as it is today in the U.S. However, a number of years ago a couple of things happened. The major one was the ability to issue a policy with a flexible loan rate. The main condition was that when the policy was issued, it had to specify that while the company could change the rate from time to time, either up or down, by giving adequate notice, it could not go above a certain level. There is a maximum prescribed by the regulatory authorities. But this seems to have given some help. The extent to which companies have used it, I'm not quite sure. But it gives you the flexibility later on, if the company deems it is necessary to raise the rate or bring it back down again. It gets to what I was referring to earlier as being able to make at least this part of your business decisions on a rational basis.

MR. DICKSON: And, yet, one of the striking things is that you're not using the full extent of the provision. At least your impression is that, in many cases, the companies are not using their full flexibility.

MR. GARDNER: No, I think you're right. The potential is there, but companies have not gotten themselves into a mold where they take full advantage of it.

MR. DICKSON: I'd kind of like to be confronted by that option right now! Despite the competitive pressures there would be an awful lot of temptation to charge a realistic rate.

MR. W. MILLER: I can share with you some things that we were told last week by some of our people in Canada who did a little looking around at our request. They looked at policy loan interest rates currently being charged by 20 large companies in Canada. The results were one at 15½%, one at 15%, about five companies at 12%, many others at 11% and 10%, and some trailing off back down. It was also our understanding that under some guidelines currently in effect in Canada, it is permissible for a company to charge a current loan rate that is in line with rates currently in effect for "self-secured personal loans". The guidelines also include a couple of alternatives for determining the maximum rate that has to at least be specified in the loan agreement if it's not specified in the policy. One of those options says you can have a maximum rate linked pretty closely to the prime rate. Another one says you can have a maximum rate that is 1½ times the current rate with which you kick the thing off. One way to characterize how this works out in practice is to issue a policy in Canada with, say, a 15% current loan subject to a maximum of 22½%. We're very obviously a long way from being able to contemplate a situation like that in the U.S.

One other totally unrelated comment, thinking over what I've heard here this afternoon. It's very interesting to me that the audience joined the panel in going a long way towards turning a discussion on the future of permanent life insurance into a discussion of the future of the traditional agency system. That either means that we're all very perceptive in recognizing this equation or we're in trouble because we are stuck to past concepts that may not adhere in the future -- I'm not sure which.