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**MANAGEMENT'S RESPONSE TO THE  
THREE SCENARIOS FOR THE 1980's**

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MR. GARY CORBETT: In this session, the three brave life company executives seated with me will each take one of the three scenarios and describe how he sees his company and the life insurance industry operating within the environment described by his scenario.

I use the term "brave" because each of them is in a position of authority in his organization and does run the risk of being quoted as saying that his company is going to do something when what he really said was that his company might do something if the scenario conditions prevailed. Please remember that I assigned them their scenarios. They did not choose them and certainly have not expressed any preference for one over another.

The first scenario listed in the program is the so called "High Inflation" scenario. Discussing this scenario is M. Gordon Gaddy, President and Chief Operating Officer of Fireman's Fund Life Insurance Company. Gordon Gaddy started in the life insurance business in 1960 and his background is in the financial and accounting area. He joined Fireman's Fund in 1968 and was elected President in 1977.

Gordon, from the perspective of 1986 have there been many changes in our industry caused by the continued high inflation rates of the past seven years?

MR. M. GORDON GADDY: When I looked at this scenario my first thought was to abandon every thought I had and resort to one of Churchill's famous short speeches which is simply "Never, never, never, never, never give up". But, instead I did come back to my choice and you will see that I used the name AMFIRE because I will be talking about a corporation by the name of AMFIRE and I will be looking from 1986 and it will be a retrospective view.

MR. GADDY: Shareholders, members of the Consumer Communications Network, Federal Trade Commission representatives, members of the Clerical and Line Managers Unions and members of the Gray Panthers. As Chairman of the AMFIRE Corporation, it is my pleasure to welcome you to this 1986 shareholders meeting.

It is obvious to all of us that the economic and social events of the past few years have required major innovations in the structure, the organization, and the product mix of our business. It is fortunate that we have survived and are, in fact, on strong footing for the remainder of the 80's. However, today, I would like to reflect on the events and conditions which have shaped this company over the past six years. This backward glance into history is necessary in order to sense our forward movements. It is essential in trying to fathom the future course of this company and our country.

\* Mr. Gaddy, not a member of the Society, is President of Fireman's Fund American.

\*\*Mr. Martin, not a member of the Society, is Chairman of Massachusetts Mutual.

The Reality of the Conditions Leading into the 80'sMyths vs Facts:

As we entered the 80's, we were a fast growing, medium-sized company in an industry that was essentially dominated by 15 or 20 very large companies. Unfortunately, for some of the major companies, this industry was more caught up in myths and traditions and, to a great extent, was ignoring the facts. Perhaps that was understandable when you consider the inhibitors such as: the difficulty of measuring company performance; the seemingly limitless market; the ease of product imitation; and the high degree of functional compartmentalization within the companies that made up our industry at that time.

Many companies were ignoring the effects of increasing costs at a time when their prices were decreasing at a rapid rate. Furthermore, the majority of the companies had failed to increase the effectiveness of the agents' sales process.

As we entered the 80's, the new ordinary life products being sold were generally of much greater value than in force policies. This was due to higher interest assumptions and improved mortality rates. In spite of this, many people in the industry continued to believe that the older and larger policies were more valuable than new policies simply because of the level premium concept and the level of accumulated cash values. In fact, the reverse proved to be true in most instances.

Existing Life Products:

At the close of 1979, the individual life line of business accounted for almost 3/4 of the statutory profits in the life insurance industry. Almost 90% of the individual life policies in force (including industrial policies) were either whole life or endowment plans of insurance. That was unfortunate as inflation ate away at the policyholder's ability and desire to afford additional insurance. People became very aware of the drastic impact of inflation on fixed dollar amounts over long periods of time; and yet became unconcerned about their future needs. All of this prompted a major shift away from traditional cash value life insurance with its fixed dollar savings element towards various types of term insurance coverage. There was a massive drain on individual life insurance reserves and the underlying investments. In many instances, policy loans were used to finance additional coverage or was used for current expenditures. The limiting of credit in early 1980 accentuated the trend that started in the late 70's. An industry which had less than \$100 million of commercial paper debts outstanding at the beginning of 1979, found itself with over \$5 billion in short term debts by the end of 1980. Short term loan activity was soon abandoned though, as this was only an interim answer to the problem. The stock companies were the most dramatically affected and felt the impact sooner than mutual companies.

However, the mutual companies did not escape the dramatic change in our economy nor the change in the psychology of their policyholders. Dividends fell short of policyholder and purchaser expectations. The investment year method and terminal dividends were both eliminated as a move to avoid insolvency and to recognize the loss due to withdrawal of funds when asset values were depressed. The policyholders in one major mutual company filed (and won) a class action suit against the company for inconsistency of treatment. Thank goodness you have been more generous with us.

Mergers and Mutualization:

As a result of the dramatic cash flow problems, profit margin erosion and the impact of adverse selection due to the dramatic turn over in healthy in force policyholders, many small and medium sized companies could not survive. Furthermore, the need for companies to broaden their product lines and their base of operations accentuated the development of an all line capability and increased the competition with commercial banks and other savings institutions.

The Federal government encroached more and more on the market by supplying more of the insurance needs of the public, and the public expected just that; but this was offset somewhat by the dramatic increase in incomes due to inflation generated wage indexing. Even still, the reduced size of the higher income market per agent that began in the early 1960's was greatly accentuated.

The result of all of the above was an industry that shrank from 1800 companies in 1979 to 200 companies in 1986. Most of these changes were through mergers, but a great many were through a combination of merger and mutualization of closely held stock companies.

Regulatory Impacts:

The confluence of the impact of National Health on the major "paper shuffling" line within the life companies and increased detailed cost disclosure requirements for individual life had a dramatic effect on the cost of doing business for life companies. The "1-2 punch" of National Health and increased cost disclosure came too fast when you consider that increases in unionization were taking place at the same time. Companies were left with shrinking insurance sales, shrinking health premium, increasing costs and demands for employee security all at the same time.

So How Did AMFIRE Survive Intact at this Point in Time?

The fact that we exist today is no guarantee that our existence will continue into the future. However, it is very important for all of you to understand how we have survived the traumatic changes of the early 80's in hopes that each of you, although diverse groups, can agree to common goals that will allow us to continue our survival and prosper into the future. Let's now consider some of the decisions and circumstances that contributed to our survival.

Market:

We accurately anticipated the public's loss of confidence in the value of future dollars. We began a major emphasis on term insurance products in 1977, and this accelerated into the early 80's. However, the most important factor was our ability to move rapidly to an effective "all-lines" base of life insurance products.

We were also ideally situated to mass market group life and other supplementary health products to the lower income market (\$20,000 to \$35,000 per year).

Products:

We were in an ideal position as we entered the 80's to rethink the relationship of our products to the consumer's changing needs due to double digit inflation and wage and tax indexing. Group life became an increasingly important element of our product portfolio as well as increasing term benefits.

The most recent advent was the introduction of our 6, 1, and 3 term products. These products have premium rates that are guaranteed only for 6 months, 1 year, or 3 years and are then subject to increase within consumerism determined limits based on indexing. This product is consistent with the fact that we had recognized in the late 70's that term premiums could not simply continue downward. We know that term products had to stand on their own from a profitability point of view as well as provide the agent with an adequate income to motivate their sale and service.

The change to term, group term and supplementary health policies did not have a dramatic effect on our results. This was primarily due to the fact that we were a relatively new company as we entered the 80's, and we did not have a substantial block of in force business and earned premium in the individual life line as compared to the giants in our industry.

Our Life Cycle package has proven to be very effective. However, we have had to dramatically change the investment policy supporting the annuity element of this package, and we are currently addressing the actions necessary to correct for the effect of increased longevity on our annuity rates.

#### Distribution System:

The double digit inflation of the early 80's rendered the sales career in the exclusive field of life insurance undesirable and impractical. However, we were prepared for this change since our agents were not limited to life insurance. We have been successful in developing prospects for our agents through direct mail and in introducing group techniques that allow them to use their sales time more effectively. We were successful in raising the sights of our producers to a level where they averaged 5 app a week as opposed to the 1 app a week that was the standard for many agents in the 70's.

#### Agent Compensation:

Agents' compensation is still generally proportional to premium income. The move to shorter and shorter period term plans increased the need to include a first-year load for agents' compensation in individually sold products. As an early advocate of policies with a higher initial premium, our product structure was already adjusted to reflect the matching of premium with the true incidence of cost.

Indexing, such as was used for casualty coverages in the late 70's, was an important addition to life insurance. This allowed for increasing the coverage without the need for intervention by the agent. Of course, a plan of action was set out in advance at the time the agent placed the policy in force.

Another very important factor was the development of professional insurance consultants who work on a fee basis. The legislation allowing for the advent of fee basis consultants was timely, and those agents able to sell their service for all lines were in an ideal position to capitalize on this new role for agents.

#### So Where Do We Go From Here?

The overriding sentiment in the early 80's was that our business and our industry was on a self-destruct course. Solvency was threatened, especially as we adjusted to current valuation of our portfolio holdings. Once the changes in the non-forfeiture regulation were made, most companies recovered but a few didn't make it through the change and became insolvent.

The demand for our product underwent changes. Inflation eroded disposable income even though taxes and wages were indexed.

With respect to the future, we have learned that we must be flexible. We must continue being prepared to make radical changes in the way we do business. Furthermore, all of us must accept the common goal of reducing inflation. This company was built on capital, technology, and managerial leadership. We must continue exerting the latter, and we must press for government fiscal and monetary policies that will bring a resurgence in both capital and technology. As the saying goes, "If you don't know where you are going, any road will take you there." It is imperative that we reach a joint decision, a consensus if you will, as to the goal of reducing inflation. This means taking actions that are politically and socially difficult in the short run. Those actions like reducing government spending, increasing taxes, reducing the money supply and loosening regulations could be political suicide but necessary at this time. I have confidence that you see the value in changing the course of events that determine our future and I look forward to serving another term as your Chairman as we proceed toward this goal.

MR. CORBETT: Thank you Gordon, for your comments on AMFIRE. Our next panelist is James R. Martin, Chairman of the Massachusetts Mutual Life Insurance Company. Jim Martin started in the life insurance business as an agent and advanced through the agency ranks to become President and Chief Executive Officer of the Massachusetts Mutual in 1968. He retired as Chief Executive Officer a few days ago but retains the position of Chairman, to which he was elected in 1974.

Jim, how does the life insurance business look in 1986 with the government pursuing its "Incentive and Investment" policy?

MR. JAMES R. MARTIN: It looks terrific. April in France! How wonderful it is to be here in Paris in the Spring of 1986. I had two encouraging experiences while sipping a bit of the grape at a sidewalk cafe yesterday. The first was to note with gratitude the return to fashion of the mini-skirt, and the second was to realize that my eyeball reflexes have not yet atrophied along with the rest of me.

I am flattered to be invited to address this august audience and want to congratulate MaryJane Magillicuddy as the new President of the Society of Actuaries. As you know, MaryJane is the second woman to be so honored. With the first, Harriett Hooper having been elected five years ago to succeed Robin Leckie back in 1981.

It is particularly appropriate that you selected Paris as the site for this meeting, your first ever held in Europe. Our being here is symbolic of the recently expanded marketing and investment activities of most U.S. life companies both in Asia and the Continent.

I suppose I was invited to this conference because, it being 1986, I have now been retired for 2-1/2 years enabling me to review the events of the first half of the 80's with a sense of detachment and objectivity that might not otherwise be possible.

In this, the third year of the government's "Incentive and Investment Policy" we are all getting a bit complacent about inflation since it has dropped back to under 5%.

The outflow of money from policy loans has slowed to a trickle, and those savings banks that survived the crunch of the summer of 1980, are rapidly increasing their deposits.

The administration's economic policy was characterized by the elimination, two years ago, of all corporate and capital gains taxes. I attribute this primarily to the work of Dr. Arthur Laffer as Secretary of the Treasury under President Reagan. You will recall, Dr. Laffer first came to prominence in connection with Proposition 13 in California.

These economic policies have also resulted in a welcome reduction in personal federal income taxes (and I attribute this mostly to the constitutional amendment) which now limits total government spending to 35% of the Gross National Product.

While it has not yet brought the full benefits originally promised, the shift away from direct performance of services by the government to contracting them out on a fee basis to the private sector is a distinct improvement. Perhaps mail service is the most startling example. Do you remember back when we had to spend 15 cents to mail a letter and service was both slow and erratic? The old gag went that 5 cents of that stamp was the cost of delivery with the other 10 cents being used for storage. What a great move it was for Metropolitan Life to diversify by taking over the entire U.S. Postal System and using their home service agents as the delivery mechanism.

Other companies have improved efficiency and reduced costs for the government, by taking over the school systems, federal hospitals, printing, and, what some consider to be the most effective of all, A.T.&T's replacing the Internal Revenue Service as the collector of all income taxes. The fact that they work on a commission basis has stepped up tax payments remarkably and virtually eliminated the underground income.

And during the first half of the 80's regulatory policy has changed too. The former "adversary and control" role of government has been reversed. While we still have extensive government regulation of business, it is in terms of broad results to be achieved rather than detailed specifications to be followed. The old system of detailed reports and rigid requirements of questionable procedures, used back at the turn of the decade, was at least partly responsible for the subsequent bankruptcy of both Ford and Chrysler. The dire economic and social chaos predicted when this resulted in a General Motors monopoly simply has not come to pass.

The business/government partnership still has room for improvement. There is growing recognition on the part of both business and government that neither can function effectively without the other.

The economy of scarcity, (with which we must now live) is partly responsible for that. Business has always been both successful and comfortable when dealing with an environment of limited resources. Before this partnership government was never able to cope with that condition.

A further byproduct of this partnership, and of the administration's "Incentive and Investment" plan, is the growing use of large private corporations to effect public policy.

I may be showing my age, but it seems to me the greatest improvement that I see in 1986 over the decade which preceded it is the welcome fading into oblivion of the "Era of Entitlement" which dominated and destroyed so many of the important things in our lives. President Reagan continues to gear his policies and plans to the citizens mood of self-sufficiency and individual independence and what a boon this has been to our business.

Another thing that has helped us has been the dramatic health breakthroughs, particularly in heart and cancer. Already we have markedly increased life expectancy for those age 50. This increased longevity (along with the system's financial woes) were the two factors primarily responsible for congress finally moving the Social Security retirement age back to 70.

And Americans now more than at any time since World War II appear to be future oriented. With a strong urge to invest and save. This use of personal financial planning is similar to that displayed by the Japanese back in the 70's. This, too, has benefited our business.

Those are some of the highlights of changes that I perceive took place during the first half of the 80's. I would now like to make some observations on the impact of these broad changes on three phases of the life insurance business - corporate management, marketing and investment.

Most all of us are now comfortable with the 1982 federal income tax reform law. It is history now but you will recall the growing discontent we had with the old Menge formula, and the great upheaval (or should I say civil war) that developed within our industry as different segments of it fought for advantageous changes when this tax law was being formed.

I suppose the main trigger that finally brought some semblance of unity happened in 1981 when the prime rate hit 24%. A growing number of companies could then foresee the real possibility that, with continued interest rates at that level, their marginal tax rate could exceed 100%.

You recall, too, that the other event which triggered tax reform for the life insurance business was the madcap rush for all of us to squeeze through the tax loophole created by modified coinsurance. We made futile attempts to explain to the treasury department (and later to congress) the logic and the fairness of a transaction which, with little more than the stroke of a pen, converted taxable investment income into nontaxable premium income. This has since been serialized into a modern T.V. version of Aesop's Fables.

You know, even the most sympathetic congressman could never quite understand how it was possible for one of our giant companies to go right on doing business and making money when they claimed to have no business in force on the books at all - it has all been reinsured.

We faced a new difficulty a year later when congress repealed all corporate federal income taxes. Our industry was faced with the dilemma of choosing between that benefit and continuing to have our policyholders enjoy the tax-free build up of cash values.

We had no unanimity of this issue either, but recent court decisions have finally settled the matter so that all life companies are taxed on the basis of net operating gains after dividends. The tax free build up has been preserved even though its importance is now greatly diminished. It was possible to resolve the sticky issue of dividend treatment only because virtually every company stopped issuing non-par business and made premium refunds or dividends to old policyholders in order to keep business in force when twisting became so rampant at the beginning of this decade.

The sweeping reform in federal taxation of our business has been directly responsible for a change in state taxation as well. The entire concept of

retaliatory taxes, that protective screen behind which we crouched for so many years, will soon be a thing of the past. Court cases reversing previous stands, coupled with a desperate need for states to replace discontinued revenue sharing funds, have led to increased state premium taxes. They are already double those of just five years ago. As you know, the federal minimum standards now require uniformity so premium tax rates for all states are negotiated by the National Association of Insurance Commissioners. Our industry now looks on this annual process by the N.A.I.C. the same way our nation looked on the O.P.E.C. country meetings before the nuclear power breakthrough.

The previously mentioned new era of government regulation has made dramatic changes on us too. Because of the government/business partnership all chief executives find themselves spending major portions of their time in the government relations area.

The old concept of "big is bad" no longer holds true. The government alliance encourages concentration into larger and larger companies with the survival of the efficient. As this decade began, we had almost 1800 life companies and, as you know, there are only about 650 now. Virtually none of those companies failed but that rash of mergers seems about complete.

The elimination of most restrictions on functions that can be performed by both life companies and other financial institutions has made it virtually impossible to distinguish significant differences among them. Symptomatic of this is the recent joint announcement by Prudential and the Bank of America of an intent to merge. I look on this as a wholly natural phenomenon since the Bank of America was one of the leading marketers of annuities last year in 1985. And the Pru showed the largest growth of any institution in the country in savings account deposits.

While we do have a National Insurance Commissioner and increased use of minimum federal standards (thanks to the more effective functioning of the National Association of Insurance Commissioners) state regulation seems solidly reaffirmed.

My company, more than most has benefited from the new "Uniform Policy Loan Provision Act". This was triggered back in early 1982 when we reached the point that almost half the industry's ordinary policy reserves were in policy loans at an average rate of 5-1/2%. That problem seems resolved now that the three elements of the "Policy Loan Provision Act" are in full force.

You recall they are: (1) companies can allocate dividends to individual policyholders to the extent that they have borrowed against their life contracts, (2) interest on policy loans is no longer deductible from either personal or corporate income taxes, and (3) we charge a variable interest rate equal to 1% below the official federal prime.

Unfortunately, it will take another ten years before we feel the impact of the latter two provisions because they apply only to contracts issued after July 1984. The dividend allocation formula can be applied to old business but no one has yet dared do so.

Federal minimum standards were also primarily responsible for adoption in all states of the N.A.I.C. model bill on cost disclosure, one with real teeth in it to penalize violators. In the early 80's, most of us ignored the harsh reality that regardless of what regulation a state passed our agents consistently failed



to comply with its provisions at the time of sale. Recent successful punitive damage suits against both agents and companies, where full cost disclosure was not properly presented prior to taking an application, have placed all this in a different light.

Of course the Federal Trade Commission has long since dropped out of our regulation picture but this really didn't happen until 1983 when Mike Pertschuck resigned from the F.T.C. to become President of Northwestern Mutual. Nothing ever came of the F.B.I. investigation into claims that seven major companies drew straws to see who would take Pertschuck on as a way of getting him out of our federal regulatory hair.

Now that most of us are marketing and investing heavily in foreign countries the regulatory problems encountered there are almost as troublesome as those we had years ago with state regulations in the U.S. There is some hope that the recently appointed United Nations Commission will ultimately succeed in establishing minimum standards for international insurance business as we did among the states in America.

Our fears that national planning would mean the end of the free enterprise system have thus far been unfounded. The National Commission for Resource Allocation has proven to be a prudent body. Stepping in to direct credit allocation only when the marketplace was obviously unable to solve its own problems.

So - our senior corporate officers have had new and nasty problems with which to cope. But the environment for them is really better now than in the 70's.

1986 is a new world for investment officers, too. The decline in inflation to the current 5% has brought a dramatic decrease in long-term interest rates. 1985 was a milestone in that it marked the first year any of us can remember when the new money investment rate in the United States was less than the average insurance company portfolio rate. The ultimate impact of this is yet to be felt, but since we all agree it is a trend likely to continue its implications are widespread.

Some mutual company dividend scales set on interest assumptions of 7% and 8% are a bit shaky though larger than anticipated mortality savings will probably pull those chestnuts out of the fire.

And those companies that in the 70's went to the investment year method for dividend scales would have the reddest faces of all were it not for the recent unusual announcement by Bo Derek, the new insurance commissioner of New York. All of us were startled when Bo declared that the former member of her department's actuarial staff who approved the Equitable's application for use of this investment year dividend concept, had been temporarily insane. This announcement raised eyebrows throughout the industry. But, then, Bo Derek is accustomed to raising eyebrows no matter what she does.

Special investigator Joe Belth has now completed his investigation and reports he found no evidence that Equitable officials had tampered with Bo Derek, though it is clear that several volunteered to do so.

Without the policy loan drag, investment officers are finding it easier to manage cash flow and the pell mell trend toward short maturities during 1980-1983 has slowed down. Maturity dates are stretching out but there seems no inclination to go back to the old thirty year fixed rate mortgage instruments.

Variable rates are rapidly becoming the rule. With the prime rate back to 6% and our average portfolio rates still at 7-1/2% and 8% (for a change) we have a solid edge on the banks. Until our heavy list of long-term fixed rate investments rolls over this advantage will make life insurance companies look very good. So good, in fact, that banks are already lobbying Congress for regulations that will stem the flow of pension funds from their accounts into our own.

The first five years of the 80's seem to have been toughest of all on marketing officers. Price competition is more acute than anyone had imagined possible. This has been partly responsible for the previously mentioned reduction in the number of companies.

Of course all insurance is now sold on a participating basis (and sales are increasing) having received a big boost from both tax law and the national attitude favoring savings and investment.

The trend towards term has been reversed so there is a clear increase in the proportion of permanent life insurance.

The pension business has been the area most changed. On the plus side, the postponement of Social Security retirement eligibility to age 70 has created a new market for individual purchases to fill the gap needed to make possible retirement at 65 or even 60. On the other hand, repeal of corporate income taxes naturally removed that stimulation for pension purchases.

Of course, pension portability is now required by all state laws. The uniform use of money purchase plans has made this far less difficult to administer than expected. And the stable 5% inflation rate appears to make indexing of pension plans not only practical but generally accepted corporate obligation.

Another change that has not shaken things up as much as feared, concerns agent compensation. As proved true for the securities business the introduction of negotiated commissions affected only 7% of the field force. The individual policy purchaser seems to recognize the need for the services of an agent and accepts the fact that he must pay for them. Since negotiated commissions apply only to cases with \$100,000 or more of annual premium the change seems both palatable and justified.

The rash of twisting which broke out in early 1980 seemed to be the final nail in the coffin for the front end load. Most every company now pays its field force level commissions for the first six policy years. This has forced an even heavier subsidy in new agent financing. But, that is offset in part by the absence of vesting for any agent with less than five years under contract.

Group has an increasingly important position in most companies but with a very different role to play. The fact that corporations no longer pay a federal income tax has stopped the trend of ever increasing fringe benefits. In addition, smaller and smaller companies are using "administrative services only" contracts.

It appears that group health insurance as we once knew it may disappear completely. After a shaky start, the rapid increase in successful individual practice Health Maintenance Organizations now makes it appear that this will be the long-term solution to the national social problem of health care protection.

This trend was coupled with the passage in 1982 of Senator Long's catastrophic health care insurance act, which mandates that all employers provide major medical coverage. The stand patters who predicted this would be the end of the free enterprise system were wrong again.

So in summary, under this scenario, the 1980's are different and they are difficult - but they are better.

MR. CORBETT: Next is Ian M. Rolland, President and Chief Executive Officer of the Lincoln National Life Insurance Company. In addition to having served the Society as a Board member and as a Vice President Ian is a board member of both ACLI and HIAA.

Ian, you have perhaps the toughest job of all in adjusting your 1986 strategies to the Social Democracy policy of our government. How is the industry adjusting to this environment?

MR. IAN ROLLAND: Discussing the conditions existing in the United States in general and the life insurance industry in particular under the Social Democracy Scenario is quite difficult since the scenario is so contrary to the principles that were employed in creating our society. It is also difficult to envision the life insurance business existing in anything close to its present form. In fact, in analyzing this scenario one has to ask whether there is any place for a private life insurance industry.

New York Congressman Jack Kemp recently said that all individuals and businesses face the same three economic decisions: between added production and added leisure; between added saving and added consumption; and between taxable and non-taxable forms of these economic activities. It would appear that many of the features of the Social Democracy Scenario will act together to raise the relative costs of production, saving and taxable activity and to lower the relative costs of leisure, consumption and non-taxable activity. In other words, it will be advantageous to loaf, spend and look for tax avoidance schemes. Resulting will be an economy in which little or no real growth is achievable because:

1. Taxes will rise from current 35% of GNP in U.S. to the 45-50% range which is now typical for Sweden and, in addition and more importantly, marginal tax rates will be extremely onerous, greatly discouraging production.
2. The dominance of the "voluntary simplicity" social value will create an environment in which growth in GNP is not regarded as particularly desirable.
3. The official support of alternative energy sources will likely lead to prohibition of nuclear and coal fired power plants producing frequent brown outs and inadequate power to support economic growth.
4. National planning and wage and pricing controls will produce serious economic dislocations involving shortages and black markets.
5. Motivating workers will become increasingly difficult under "guaranteed employment" conditions, and
6. What investment that does exist will be skewed to bureaucrats'

definition of socially desirable rather than directed by the market to the most productive area.

The fact that the policies of the Social Democracy Scenario have worked reasonably well in the Scandinavian countries is not sufficient evidence that they will work in the United States. Sweden and Norway are small homogeneous countries (population of 8 million in Sweden and 4 million in Norway) with long traditions of paternalism. In addition, these countries have a high rate of saving and investment relative to GNP and rapid productivity growth plus the discipline of large export and import sectors. Thus, industry in both countries must compete vigorously with foreign companies. None of these conditions exist in the United States which is currently plagued with low rates of investment and productivity and where foreign trade is low in relation to GNP. It is quite possible that components of the Social Democracy approach will exaggerate these U.S. economic problems.

The life insurance business will most likely not prosper in the social democracy environment. The zero growth economy coupled with increasing taxes imply a decrease in disposable income among typical consumers of life insurance products. In addition, the government will be assuming a much greater role in the providing of financial security leaving a reduced role for life insurance companies. The result will be little or no growth in life sales.

The U.S. Consumer Agency with jurisdiction over life insurance marketing will make the sale of life insurance through individual agents most difficult. That agency will undoubtedly follow up and expand upon the work of the FTC. Agents will be required to deliver detailed information about the policy prior to taking an application. The rate of return index will be included in that information as will the amounts of commission the agent will earn. The Agency will control life insurance rates and benefits through establishing minimum rates of return and early year cash values for ordinary life policies. These minimum early cash values will force leveling of commission rates. The Consumer Agency in a massive and well-financed educational campaign will encourage the use of term insurance, and consumers will respond by buying primarily term insurance. The Agency will move the industry toward "social insurance" concepts by prohibiting inspection reports and the use of MIB information in underwriting life insurance. In fact, there will be a distinct trend toward eliminating substandard ratings except for factors under the insured's control such as hazardous hobbies, smoking, etc. Unisex mortality tables will be required in spite of strong statistical evidence supporting a differential in rating by sex.

With a market that is stagnant, a major rise in term insurance, limitations on commissions, the end of health insurance and the general dependence on government for security, it is easy to envision the collapse of the current life insurance system of marketing through individual agents. The productivity increases that are so vital to the health of our current life insurance sales organizations will not be achieved. In fact, steady decreases in productivity will undoubtedly be a way of life. The situation will be aggravated because job security legislation would make it very difficult to terminate less productive agents. This will produce an environment where competition among the remaining agents and companies will be intense with considerable churning of business and rising lapse rates.

The individual agent marketing system will be replaced by mass marketing approaches. The sale of term coverages through the mail, credit cards, etc.

with low sales expenses will predominate in the marketplace. The programs will involve minimal underwriting and simplicity of benefits.

It is also likely that the government will emerge as the principal marketer of life insurance benefits. A government owned National Life Insurance Company will be established to market low cost life insurance through the social security system replacing completely the debit insurance system. Social Security itself will involve greatly expanded survivorship benefits that would guarantee adequate incomes and educational benefits to survivors. The market for life insurance at all income levels would, therefore, be severely curtailed.

Under this Social Democracy Scenario, perhaps the most drastic impact on life insurance companies will be in the investment area. It is difficult to see life companies acting as accumulators of large pools of investment capital as at present. It is probable that life companies will experience major decreases in pension deposits as public employee unions (especially hospital and teacher unions) and many individuals direct their own and employer's deposits to the National Pension Corporation. It also seems probable that over the years greater and greater incentives would be provided to individuals directing funds to the National Corporation, and ultimately all pension deposits would be required to be placed with the National Corporation. In the longer term, it is also possible to envision the expansion of retirement benefits under the Social Security system to the point where the National Pension Corporation would be merged with Social Security, eliminating entirely the private pension system.

The increasing use of term insurance will also reduce the asset base and the cash flow of life companies. Much of the whole life insurance which is currently in force will be surrendered or loans will be placed on policies that remain in force. Under such conditions very little will remain of the investment role of life companies as we know it today. What is left of the investment function will be closely regulated. Using tax incentives, the National Planning Agency will direct investment of life company assets to socially useful ends as defined by the Agency, e.g., certain percentages of assets must be invested in inner city home loans, rural home loans, small farmer loans, small business loans, etc.

The manner by which life insurance companies are managed, governed and owned will be dramatically altered in the Social Democracy environment. Stock companies will cease to exist as they are mutualized or converted to some form of public ownership. Both employees and policyholders will have substantial representation on life company boards. Through these representatives, policyholders will have major input on surplus allocation decisions as well as in formulation of marketing and pricing policies. Employee representatives will play an important role in determining all personnel policies. Under this structure, management will have to be quite adept at developing a consensus among employees, policyholders and regulators in connection with a multitude of company policies, both major and minor.

Now let's explore briefly what it will take to be relatively successful in this environment. While conditions would seem to be adverse for life insurance company development, it is important to remember that certain companies will always stand out and prosper in any environment no matter how adverse. It seems to me that the companies which will prosper will be distinguished by the following characteristics:

1. They will deal effectively with the problems of sales force productivity. This involves solving the problems of agent retention, producing a high level of sales per agent and most likely decreasing their reliance upon sales through the individual agent.
2. They will be characterized by high levels of productivity in their administrative operations. Staff growth will be carefully controlled and work flows will be organized in a particularly efficient manner.
3. They will develop an effective marketing strategy which concentrates on a particular niche in the marketplace, and they will know precisely what they want to be and how to achieve their goals.
4. They will develop a cooperative relationship with employees which will be characterized by good communications, a high level of trust between employees and management, and significant satisfaction for employees through challenging jobs.
5. Product development will be innovative as unique products are developed to take advantage of the high tax rate environment coupled with any tax advantages available through life insurance products.

In total, President Metzenbaum's New Economic Policy will be tough on life insurance companies. A smart actuary will join the new consumer agency, not a life company. A CEO should probably start lobbying for the job of heading up the new agency governing life insurance marketing of the National Pension Corporation. As for economists, there will be plenty of jobs at the new Economic Planning Agency, and the greatest demand will be for the politicians and bureaucrats who will have numerous choices. See you in Washington D.C.

MR. CORBETT: I think you will agree that our panelists are indeed brave men - to take on a very unusual assignment and to place themselves into environments not of their choosing. They displayed not only courage but also intelligence and adaptability - qualities necessary for the successful executive in the 80's.

Before opening the meeting to comments and questions from the floor I would like to provide some time for Jim O'Toole and the panelists to comment on how they might operate differently in one of the environments. Also, we have seen that some environments are more favorable to life insurance companies than are others. What can we do as life insurance executives to increase the probability that these favorable environments are realized?

MR. MARTIN: I have some comments with respect to regulation and over-regulation. Everyone in the decade ahead has the social responsibility as individuals, and as corporations, that whenever a regulator makes a decision that affects you and your company which in your judgement is not in the public interest, you have

that obligation to fight them in the courts, in the congress, in the state legislature and, if it doesn't work there, in the back alleys. In my experience many, many times the decisions made by regulators are not supported by adequate research or evidence of reason and are in fact personal decisions. Also, I find out an equal number of times that they are made without authority. Like vampires and opossums they do not function well when exposed to the strong light of day. I would urge you fight them.

MR. ROLLAND: I wouldn't want to disagree with Jim Martin at all. However, before we get to the point of fighting the regulators maybe there are things we can do on our own. Obviously our business is not perfect in all respects and it is important for us to always critically review ourselves and look for areas where we can improve the way we do things. It seems to me that the most visible area of activity for this business in the future is going to be the way we perform in the market place; that is the way our agents and sales people represent us; the kind of information that is given to the consumer so that those consumers can make intelligent choices; and the expense involved in the distribution of our products. Our whole structure of marketing and distributing our products is one that probably needs some very careful evaluation, work and attention if we are really to move into a more accommodating environment for our business in the future. It seems to me that we do erect for people that try to do business with us some significant barriers in the terms of paperwork, comprehensibility of our business, our policy forms and our whole approach. Somehow we must make ourselves more understandable to that public. Where we interact with them we must do it on a better basis than we have in the past.

MR. GADDY: Regarding regulations, in response to the federal government's somewhat "kneejerker" response, the states at the regulatory level are under pressure to enact or promulgate regulations that essentially become a defense against anything that is new or different or competitive. They use the states as a kind of last bastion of defense against anything that is new or competitive. This is really working to our disadvantage now because a number of companies have the money, the energy and the desire to overcome this, and it is going to create an increasingly high profile conflict situation. Not all of the regulatory activities emanate from the regulators themselves (although I think a fair amount of it does, obviously). A politician is more powerful with stronger regulations. But, it is going to take a lot of dialogue and discussion amongst ourselves to avoid, in our conflict with one another, creating worse regulatory environments.

MR. CORBETT: Jim, I would like to ask you as an outsider here and somebody who wrote the scenarios and is quite conscious of them, "What do you feel about the responses you have heard to them?"

MR. O'TOOLE: Let me say something about the scenarios in general. First of all, these are very extreme scenarios, and I don't think anyone would expect a highly pluralistic nation like ours to evolve in exactly these ways. The extreme nature of the scenarios drew extreme reactions to them on the part of the panel. On the whole the panel was a little too pessimistic about the pessimistic ones, and a little too optimistic about the optimistic ones.

In analyzing the Incentive and Investment scenario that Jim Martin looked at, I think there is a chance, today, that we might try some of these things in

the United States, where we wouldn't have considered this course five or six years ago. But the question is, "If we try the things that are suggested in that scenario, are we sure that they will work?" If these things are tried, and they fail to meet the very high expectations that are being created for them by Art Laffer and others, what is going to happen then? The Proposition 13 experience in California may be backfiring now. A lot of things wonderful were supposed to happen to the economy as a result of the passage of Proposition 13, and they haven't happened. Consequently, we are getting a little bit of a backlash. The British experience with Mrs. Thatcher is moving in the same direction. We have to be very careful about letting our nostalgia carry us away to the point where we believe such an extreme scenario is practical. For example, I can't think of anything that would get rid of the "entitlement consciousness" that we have in the United States. As a matter of fact, the only thing that would really get rid of it would be a good depression, and I am sure none of us wants that.

Looking at Ian's scenario, if we are going to be really honest with ourselves, we have to recognize that society is trending towards such egalitarianism. Although it is not my favorite scenario, if we were to put it to a vote of the American public, they would probably choose this scenario over the other two. So I think this scenario has a rather high probability, at least as far as certain aspects of it are concerned. For example, I don't think that permanent wage/price controls are really in the cards. On the other hand, National Indicative Planning in one form or another is in place in Japan, Germany and Sweden. It seems to lead to high savings in those countries. Since America is going to be constantly measured against the success of our competitors, it is going to be very hard to reject what they are doing on ideological grounds. One other thing I might point out is that the British system, until the last couple of years, had been far more radical than what is described in the Social Democratic scenario. Since life insurance is still alive and well there, I personally would not be as pessimistic as Ian.

Finally, let's look at Gordon Gaddy's High Inflation scenario. If Robert Heilbroner and others are right, inflation is now a structural problem in the United States. Heilbroner has done a lengthy analysis showing that every type of political economy carries along with it an inherent set of problems. The free market economy of the 1920's had an inherent tendency towards boom and bust that led to the Depression. Now, through labor union activity, government regulation and a lot of other structural changes, America has gotten over the risk of a depression. But Heilbroner points out that we have built inflation into our system. And the only way to get rid of inflation is through a major structural change. So something very radical might then be in the offing.

Now, if we want to avoid some of the worst aspects of these various scenarios, what is it we could do? I'm not sure that we have in this room (or in the business community in general) the power to deal with the problem of inflation. We hope, then, that the government will take care of that. What about the other problems that were brought up? In this regard, self-regulation is very important. Your industry has to be clean and it has to be candid. My feeling is that model industries are less likely to be over-regulated. The performance record of an industry, and the service it provides, will have a lot to do with the kind of regulation it will get.

I would like to follow up on what Jim Martin said. Your industry is going to have to learn to play pluralistic politics better than you have, and you will have to learn to play it responsibly. The Mobil Oil approach does not do anything but create hard feelings. But, providing the right kind of



information to people is a key way of doing this and, also, of making allies, like labor unions for example, who can carry your case to Washington.

Perhaps, the most important idea was inherent in everything Gordon Gaddy said in his admirable call for flexibility on the part of your industry (Ian seconded this). You have to learn to encourage and to reward entrepreneurial thinking. You cannot be bureaucratic in response to the bureaucrats in Washington. I think you have to put the enterprise back in free enterprise. And finally, I would like to offer my own "Churchillian" statement as to what you ought to do: plan, plan, plan.

MR. CORBETT: Now I invite you to direct your comments or questions about the future to Professor O'Toole or to any of our three panelists.

MR. WALTER MILLER: I have a question for Jim Martin. Jim, in your scenario one thing that you put into your history of what happened in the early 80's was the development of level commissions. I doubt that in that sort of scenario this would come about because of the type of reasons that Ian mentioned, such as passage of federal legislation mandating minimum cash values in the early years. Could you tell us why under your scenario you think this would happen and how it will happen?

MR. MARTIN: I put that in because under that scenario it is our only defensive mechanism that I could find against the motivation for twisting. We are getting into the real world now and I think that 1980 or perhaps 1981 as well is going to see a rash of twisting by agents of ordinary life policies from one company to another. The more cost disclosure we have the more likelihood that this is going to come about. Therefore, one of the things that we are going to recognize as we do that is that those high first year commissions, the motivation for the agent, become almost irresistible. You know we can rationalize (remember I came up through the field force so I know whereof I speak) a reason for doing anything that is in our own best interest as an end result. One deterrent would be the fact that he has six or eight 10% to 15% commissions instead of a 55% first year commission.

MR. MILLER: One further question on that. In your opinion is it possible for some companies, who are interested in continuing to recruit agents, to introduce level commission scales at a time when all companies are not?

MR. MARTIN: I think so. It better be that way because I cannot think of it happening under any other set of circumstances. It will not be legislated. You recall that, I also mentioned it is going to require a much heavier subsidy on our corporations' part to those agents in their early years. If we take an agent who is ten years in the business now and suppose he's making in excess of \$40,000 per year, we will phase him into this. Yes, I think it is possible.

MR. ROLLAND: In order to achieve what you hope would happen, you would have to get universal acceptance in the industry on the part of almost all companies that replacements are bad, that they should be discouraged, and that agents should not be paid for churning business. This industry is varied enough in their marketing approaches that it would be difficult to get that kind of uniform reaction to this problem. You may have some companies moving in that direction while others would be promoting the idea of replacements and churning. How do you get around that problem, Jim?

MR. MARTIN: Understand Ian, that I did not propose that making level commissions was going to be the solution of all of life's problems. However, at least it

will slow down the trend towards our own agents twisting our own business. If there is anyone in the room who does not think that is happening to an increasing extent, I urge you to go back and take another look.

MR. GADDY: On the issue of the commissions, from my perspective we are better off with a higher first year premium that reflects the matching of the incidents of cost with the policyholders payment of a higher premium. To levelize the commissions you are building in a higher renewal premium. As long as there are policies out there that can out-perform the existing policies you have got the problem of potential replacement, potential churning. Obviously churning is not an acceptable solution. Replacement is not an acceptable or justifiable marketing philosophy. However, as long as it is a symptom and until we get to the point of either updating the benefits or changing the way we structure the pricing in our products, we have got this problem and I agree with Jim. It is going to be worse and is already terrible right now.

MR. MARTIN: You know, I don't mean to hang my whole career on leveling those first year commissions. However, I do think we must do one thing that we have not yet done and that is to compensate agents and general agents/managers for doing those things that the company wants done and are in our best interest. We are not doing that now.

MS. BARBARA LAUTZENHEISER: I have a question for Mr. O'Toole. He indicated that all three gentlemen had swung their pendulum possibly too far and taken the scenarios further pessimistically or optimistically than they possibly should have gone. Gary Corbett indicated that Ian had been coerced into taking the worst of the scenarios and yet Mr. O'Toole indicates that we definitely have a egalitarian society. How far down that road are we already and where do you see us going in the next ten years towards that scenario that Ian had to give and we did not like?

MR. O'TOOLE: I would not suspect that we will ever swing fully back to a free market economy. What may happen is that we will not swing much further in the direction of a welfare state than we have, but that we will stop for a while and take stock of where we have come over the last decade or two. However, trying to remove some of the existing forms of social welfare and regulations would be very difficult. So, while I don't think we will move all the way to where Sweden is or where Britian has been, I would be equally surprised if we were to swing all the way back to a completely free enterprise. I would mention one thing more with regard to Ian's comment that he couldn't see any room for private insurers in his scenario. Over the last 15 years of increasing regulations, every time a new regulation has been proposed, the leaders of major corporations have said that if they get the next one, that's the nail in the coffin, and industry will be dead. But, every time the nail is driven in the coffin, six months later corporations have learned to capitalize on it and do well. So, even if the things go as badly as they seem in Ian's scenario (and I think it is a low probability that it will go all that bad), I have a feeling that people in this room are creative enough to find a way to adjust to it, and make the best of it.

MR. ROLLAND: I would agree with that. I do not think that I said that there wasnot a place for the private life insurance business. I do think I said that one had to at least ask that question or at least explore that alternative. As Jim said, companies in this country are pretty innovative in dealing with regulations and I suspect that some companies would survive fairly well in this type of environment. However, it would be much more difficult than it is currently and I think the companies would be much different in character than they are now.

MR. GADDY: One of the things that strikes me is that, even in the Incentive and Investment scenario, 5% inflation is not that easy to deal with when you consider what we are coming from, where the bulk of the assets in this industry are invested and how the bulk of products are designed and priced. So 5% inflation, even in the best scenario you have, is not an ideal situation.

MR. ARTHUR DUMMER: I would like to direct this question primarily to Ian and perhaps others who might have something to offer on it. Ian, you suggested that there would be companies who could survive in the Social Democracy scenario. I would be interested in your comments on what their characteristics might be, what you think they would be like and to add a little perspective on that by someone who is better informed than I on what companies are surviving in Scandinavia now. What life insurance and other health insurance companies are surviving in that type of an environment now? What are their characteristics?

MR. ROLLAND: I cannot bring you up to date on Scandinavia, somebody else is going to have to do that. The companies that survive in that environment would be companies that have learned to operate very efficiently and minimize their expense loadings in their premiums. Also, survivors would be companies that are not strictly dependent upon distributing through individual agents because I find it difficult to imagine an individual agency marketing system could survive well in that environment, at least the cost would be too high to support it. There would be companies that had learned to market in some sort of mass way, e.g., mail order or credit cards. Those are some general ideas. There would undoubtedly be others that would survive. Probably companies that would develop products that would be responsive to the high tax environment would survive. Undoubtedly there are products that could take advantage of the high tax rates and commensurate tax advantages that are given to life insurance products. Possibly those could be sold.

MR. O'TOOLE: America cannot go as far as they have gone in Scandinavia for structural reasons. They have, in effect, one national pension system that is the equivalent to our Social Security plus our private pension system. This money is used as risk capital in their society. We cannot go in that direction. We could not put private pensions and public pensions together and use that money for investments. Could you imagine the economic dislocation if all that money were in the Social Security Administration and they were to invest it in the stock market? Because of the kind of economy we have, I think that it would be a very low probability that we would ever move to the very extreme situation that they have in Sweden. You just don't develop the logical steps to get us from where we are now to what they have there. We will probably come up with a much more American model and not borrow directly what they have in Sweden or in any other country.

MR. ERNEST J. MOORHEAD: My question is about state regulation, and it is for Mr. Martin. It has to do with a remark you made during your formal presentation in which you visualize a condition in which the survival and prospering of state regulation was due to a stronger and more effective National Association of Insurance Commissioners. What do you visualize that the companies themselves will have done to make the NAIC function in a way that it certainly is not succeeding and functioning now?

MR. MARTIN: Two things we can and must do. First, we have to help our new governors in every way we can with the selection of more qualified people to be insurance commissioners in those states where they are appointed. Where they are elected, we have to get involved in the governmental process to see that more qualified people come up through that route. Second, once they get

in place, we do have to see what we can do to help them e.g., loan them staff, do research for them, counsel with them. As far as the organization itself becoming stronger, we can help by being more respectful to them and again help them as an organization as well. Let them become more familiar with our problem.

MR. JOHN MAYNARD: I have a question for Mr. Martin. One of the reasons that he felt rather pleased with his scenario I believe was a development in the first five years of the 1980's in which the conditions surrounding policy loans were changed. He mentioned that from 1986 looking backwards, it had been possible to arrange for a policy loan interest rate related to the prime rate. I think most people would agree that if this were done it would be a very helpful thing for the life insurance business. I wonder if he would tell us if he has thoughts about how this might be accomplished and whether actuarial bodies would play some part in bringing this about?

MR. MARTIN: I happen to head an industry task force now that is searching just for that type of a solution. Already we have come to the conclusion that we need a variable rate, with the question still being open as to whether this can be best achieved through state regulation or legislation as opposed to some form of federal intervention. One part I did have in my script and removed (in order to keep us within our time limit) was a recognition that any of these changes were going to take at least ten years and probably longer before we could feel their impact, because there is no hope or expectation of doing anything with respect to the business that is now in force.