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THE FUTURE OF PERMANENT LIFE INSURANCE

Moderator: JAMES W. KEMBLE. Panelists: PAUL J. OVERBERG, ALAN RICHARDS, RICHARD M. STENSON

1. Will cash value life insurance as we know it continue to be viable in light of:

   a. Uncertain economic future?

   b. Double-digit inflation?

   c. Increasing policy loans?

   d. Extremely competitive term policies?

   e. Replacements?

   f. Attractive alternative savings products?

   g. Consumerist and regulatory atmosphere?

   h. Possible changes in tax, nonforfeiture and valuation laws?

2. If the answer is no, what type of products should be developed to:

   a. Serve the needs of the consumer?

   b. Maintain the economic viability of the company?

   c. Solve the problem of marketing compensation?

3. If the answer is yes, what modifications, if any, should be made to existing products?

4. What are the current effects of replacement on both the life insurance company and the consumer with respect to:

   a. Deposit term?

   b. Single premium whole life?

   c. Other products?

MR. JAMES W. KEMBLE: Our subject is the future of permanent life insurance. The subject has become so wide-open within the last two or three years, that I find myself at a loss to be able to define what is meant by traditional cash value life insurance. We will dispense with the definition and have a rather wide-ranging discussion.

This has been, and is today, a much discussed subject. First, there are an increasing number of detractors from what we know as permanent or cash value life insurance; for example, consumer groups which, in general, are not great promoters of cash value life insurance, the FTC and other Federal regulators who have been critical of the way it has been sold over the years and many non-life insurance company savings institutions who have made negative comments about the values in permanent life insurance.

Secondly, there is a slightly declining, but still very vocal group of purists who are staunch defenders of cash value life insurance. These purists include those who promote the virtues of automatic savings achieveable through cash value life insurance and those who say that perhaps there is a place for term insurance, but only as auxiliary coverage.

The majority view seems to be that both permanent and term insurance are important in the scheme of things. This view recognizes both our long- and short-term needs and allows us to look at other investments. (I hope nobody believes it is heresy to say that there are other means of investing.) As usual, these "moderates" are probably less vocal than the extremists.

There are several sources or reasons for disagreement about the value and the future of permanent life insurance. The economic uncertainties of the last several years have certainly been among the most prominent reasons. Currently, because of the inflationary conditions many people, especially at the younger ages, find their needs for protection outstripping their ability to purchase it, particularly permanent cash value insurance. As we all know, the guaranteed, low return on cash value life insurance leaves something to be desired in the eyes of many people. To these people, the higher returns they can achieve in other areas are more attractive. As a result, we have a replacement problem, we have increased lapses and, of course, we have a sizeable policy loan problem. Another reason, in my opinion, is that sales forces often overemphasize the savings element in life insurance. The savings element is important, but it should not be the reason for buying life insurance. Some commission schedules are unrealistic and sometimes the incentives are misplaced. Believe it or not, agents do know how to read sales contracts. High compensation can result in an even more noncompetitive return from the savings element because of the high load on the total premium. There is current emphasis by investment advisers away from long-term guarantees and into the money market. This emphasis does not encourage the long-term cash value life insurance approach. The consumerists have awakened to the big, sleeping giant of the life insurance business, and their efforts to explain its economics to their clients have developed a proliferation of cost measurements, some of which I think I understand, many of which I am not sure of.

Lastly, there has been an apathetical attitude on the part of many companies and their spokespeople, believing that disagreement will subside and everything will be great in five years. I do not believe that.

Our purpose today is to determine if a problem exists - if so, to define it and to discuss some alternative solutions. I doubt that we will discover the one solution today, but I think we will at least go away having a little better foundation for helping our employers or companies make appropriate decisions.

It occurred to me that a few statistics might help our perception of the subject we are about to discuss. The following tables are based on numbers published by the ACLI in recent editions of the Life Insurance Fact Book.

- Proportion of Ordinary Insurance In Force by Plan (based on Face Amount)

Year	Permanent	Term
1970	71.5%	28.5%
1974	69.0	31.0
1977	66.7	33.3

- Proportion of Ordinary Insurance Issues by Plan

1968	57.0%	43.0%
1978	48.0	52.0

- Distribution of Life Insurance Premium Income

Year	Ord.	Group	Indust. + Credit
1975	71.7%	19.8%	8.5%
1977	71.5	20.3	8.2
1979	71.5	20.4	8.1

- Distribution of Total Premium Income (Indiv. + Group)

Year	Total Prem. (Millions)	Life Ins.	Annuities	Health Ins.
1975	$58,575	50.1%	17.4%	32.5%
1977	72,319	46.7	20.7	32.6
1979	84,916	46.0	21.1	32.9

- Comparisons to Disposable Personal Income (U.S.) - Ratios To D.P.I.

	Life Insurance Amount		Premiums			
Year	Per Insured Family	Per Family	Ord. Life	Total Life	Annuities	Total
1930	NA	147%	NA	NA	NA	4.72%
1950	150%	115	2.18%	3.04%	0.46%	3.50
1965	231	190	2.48	3.41	0.48	3.88
1975	232	198	1.95	2.71	0.94	3.65
1976	230	198	1.90	2.64	1.18	3.82
1977	230	198	1.85	2.59	1.15	3.73
1978	229	197	1.81	2.51	1.12	3.63
1979	231	198	1.72	2.41	1.10	3.51

These tables reflect some of the expected trends, particularly a movement towards a heavier proportion of term insurance. For those critics who say the life insurance business is not performing, I should like to point out that the amount of protection in force still remains about two times the disposable personal income in the United States. Despite recent inflation, the public has apparently continued to perceive its need for the primary product of the life insurance companies.

The tables do indicate that the portion of disposable personal income being put into life insurance company savings - related products (annuities, permanent and endowment policies) is decreasing. I wonder what the experience of the banks, S & L's and similar institutions has been?

MR. PAUL J. OVERBERG: This morning, I will try to help you keep a proper perspective on the entire subject of the future of permanent life insurance. Our moderator, Jim Kemble, showed how permanent life insurance sales have been decreasing as a percentage of total sales. However, I will be viewing today's discussion from a slightly different perspective, that is: "The future of whole life insurance". Before I go further, you should all be aware that last year 74% of Allstate's ordinary sales by amount were term insurance.

Let us look at industry sales by plan of insurance. Table A shows the industry statistics for ordinary sales by plan of insurance as published in the Life Insurance Fact Book. From 1968 through 1978, whole life, based on amount of insurance, accounted for approximately one-fourth of all sales. Whole life is defined as level premium, continuous pay policies. It excludes modified life and limited pay policies. It also excludes whole life policies with term riders and Extra-ordinary life (EOL) type policies. High premium plans have been dropping in market share, and term insurance has been increasing in market share. Most of this change in mix has occurred since 1973.

When measured by number of policies or by annual premium, both term and whole life have been taking an increasing share of the market over the last decade. For 1979, when measured by annual premium, whole life had 47% of the market, and term had 15% of the market. The above statistics indicate that whole life insurance, as we know it today, will continue to be viable throughout the 80's.

One alternative to whole life insurance is to "buy term and invest the difference in the stock market". Table B is a graph of the Dow Jones Industrial Average for the last ten years. I have plotted the highs and the lows for each year. The Dow hit a high in the last decade of 1,052 in 1973, and in 1974 it hit a low of 578. To give another perspective I will read a letter that was published in the Financial Section of the March 20, 1981 Chicago Tribune.

> In July, 1977, a stockbroker induced me to buy a stock at $14.62 a share. He called me at home and work two or three times a week and also wrote me letters, urging me to buy before the stock took off. He assured me that I would make money.
>
> The stock never rose above the price I paid for it. It went down. Now the company is in bankruptcy. The broker never called me since the day he sold me that dog. Do I have any recourse against the broker?

Table "A"

"Ordinary" Life Insurance

Purchases In The United States

By Type Of Policy*

	1968 %	1973 %	1978 %	1968 To 1978 Change %
Whole Life	26	25	26	0
Level & Decreasing Term	21	24	38	17
All Other	53	51	36	-17
Totals	100	100	100	0

* Based on amount of insurance.

Source: 1974 & 1980 Life Insurance Fact Book.

TABLE "B"

Dow Jones Industrial Average
High and Low Prices at Daily Closing
1970-1980

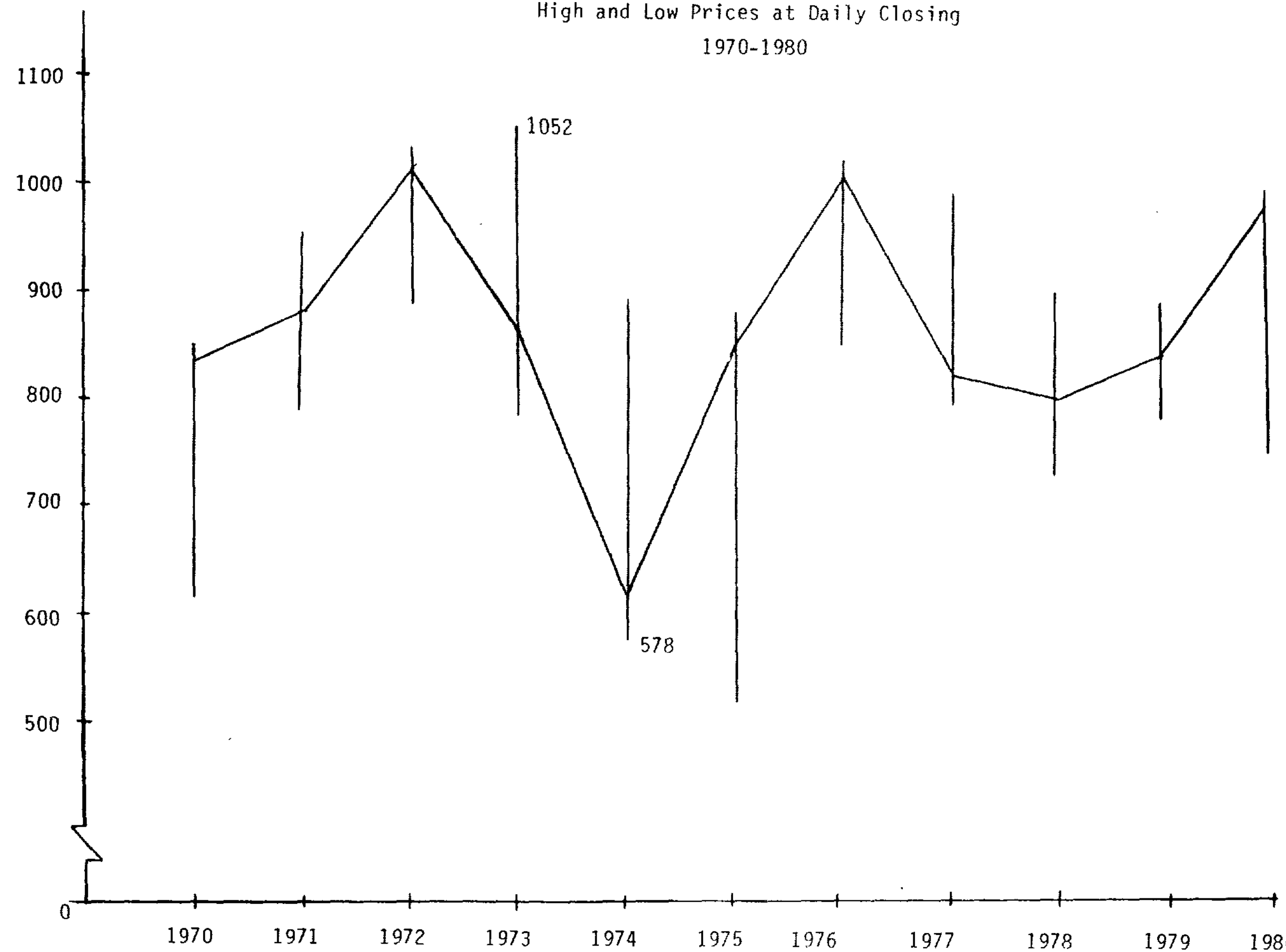


TABLE "C"

Long Term Interest Trends

(Plotted Quinquennially)

MOODY'S COMPOSITE ANNUAL AVERAGES OF CORPORATE BONDS

U.S. Life Companies Net Rate of Investment Income

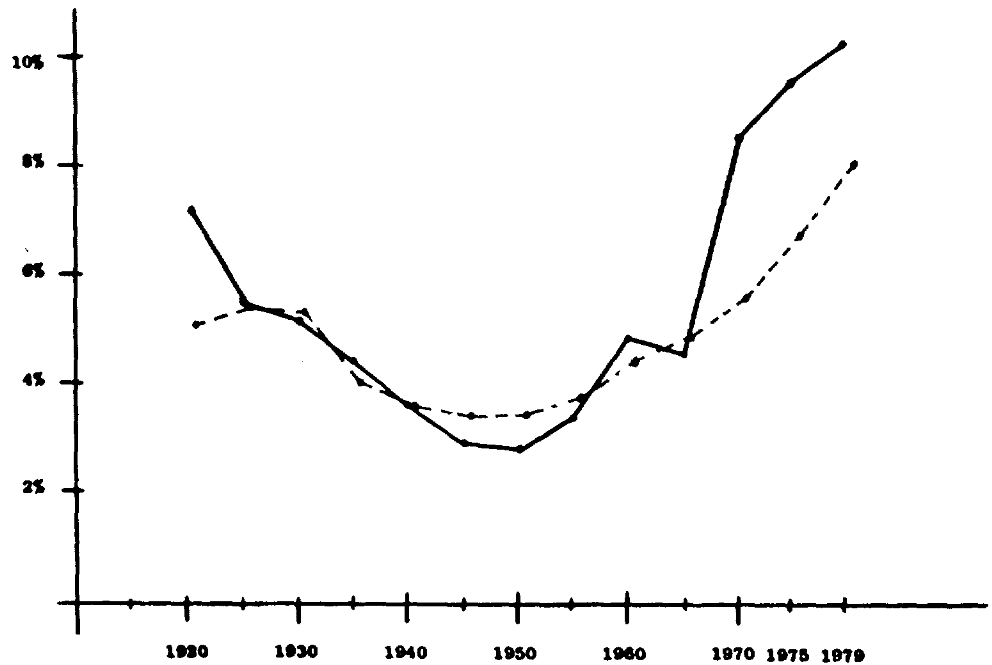
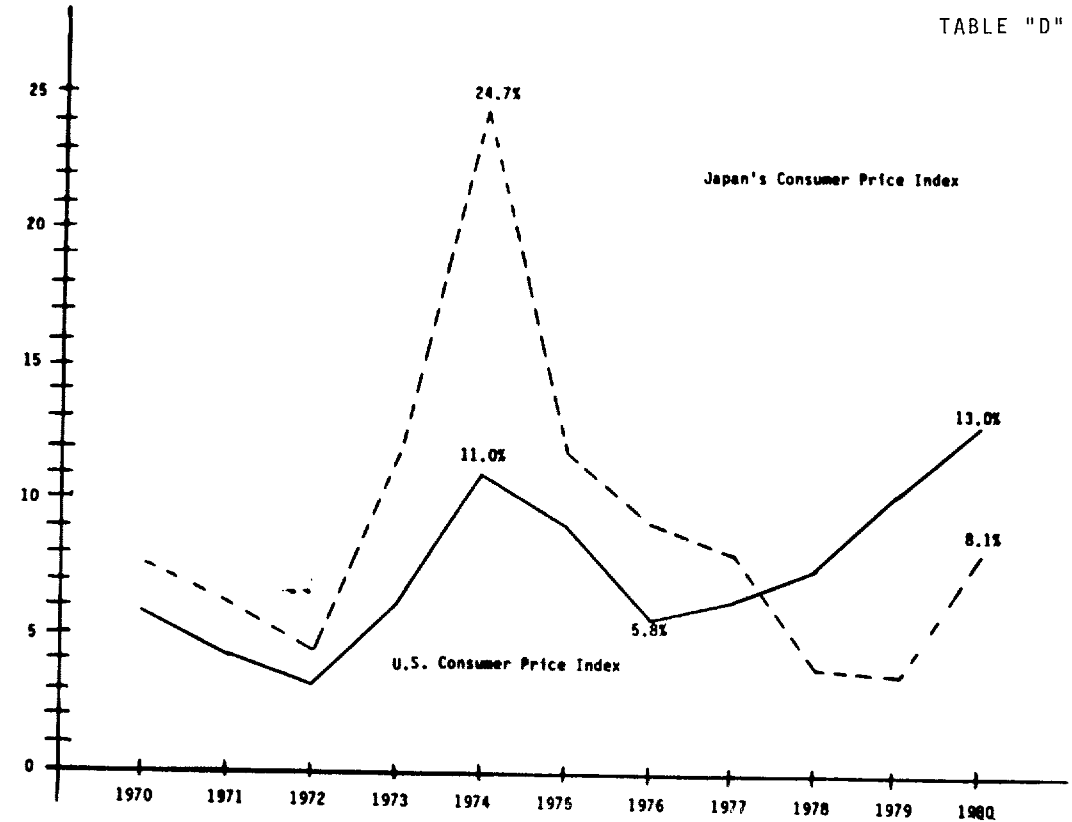


TABLE "D"



Japan's Consumer Price Index
U.S. Consumer Price Index
24.7%
11.0%
13.0%
8.1%
5.8%
25
20
15
10
5
0
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980

This individual could have bought a whole life policy from almost any life insurance company in the Unites States and experienced a better rate of return than he or she received on that "dog", as the stock was called. When you look at how the stock market has performed, can you really advise the average American to invest in the stock market or in equity mutual funds?

This lack of financial security applies to a lesser degree to other types of investments. In fact, the currently popular money market funds are not guaranteed either as to earnings rates or even as to the basic capital investment. It is possible that some people may lose money in the money market funds.

Table C shows the Moody's composite average of corporate bond yields over the last several decades. Also plotted is the investment income rate of life insurance companies. Currently, interest rates are at all time highs, but is it reasonable to assume that interest rates will continue indefinitely at these levels? Chase Econometrics, Wharton Econometrics and Data Resources are all indicating that the prime rate could be down to 10% by December, 1981. They also forecast inflation to be in the 8% to 9% range by year end 1983. Thus, during the next decade it is not impossible for inflation to be as low as 3% and interest rates to be as low as 3%. Each of you can forecast the interest rate just as accurately as any economist. So make your own "guesstimate" as to the interest rates for the eighties. If interest rates moderate and stabilize, cash value life insurance will undoubtedly prove to be a better buy.

Table D shows the U.S. Consumer Price Index for the last 11 years. Theoretically, interest rates and inflation rates should be related. During the last several years, many people have grown accustomed to high inflation. This "high inflation psychology" does, to a certain extent, perpetuate high inflation, but it does not mean that high inflation is inevitable. Chart D also shows Japan's Consumer Price Index for the last 11 years. Japan hit an inflation rate of almost 25% in 1974, yet four years later, the inflation rate had dropped below 4%. The inflation rate in Japan and the U.S. is affected by government action. World War II and price controls under President Nixon both brought a controlled economy to the U.S., which few, if any, had predicted. With today's international unrest, we could have another controlled economy in the U.S. in the 80's.

There are many other perspectives that should be kept in mind before deciding on the viability of whole life insurance in the eighties. I will mention a few of these.

First, the relative cost of whole life and term insurance has changed over the last 20 years. Currently, term insurance rates compared to the whole life rates of various companies, especially at the higher amounts, appear to be a better buy for many companies. However, similar studies made 10 to 20 years ago tend to show whole life policies as the better buy. Such pricing may be partly the reason why term sales have been increasing.

Another perspective is the rates of commission paid to agents on whole life and term insurance. Currently many, if not most, companies pay a higher rate of commission on whole life than they do on term insurance. If commission rates were to be equalized, the relative amount of whole life sales might increase. Such commission changes could reduce the relative cost of whole life as compared to term, and perceived conflicts of interest would be alleviated, if not eliminated. Although there has been no wild dash for companies to equalize agents' commission rates, there are an increasing number of companies that have done it. This trend could rapidly increase, if the New York insurance law were modified to permit the same commission rate on term, as is allowed on whole life. While equalizing agents' commission rates may not be necessary for the continued viability of whole life insurance, it undoubtedly would not hurt whole life sales and may even help them.

A third perspective is the small policy market. Sometimes we, as actuaries, may forget that we are not an average life customer and that our likes and dislikes do not necessarily reflect those of our customers, especially the small policy market customer. According to LIMRA's 1979 Buyer Study, 54% of all ordinary policies sold in 1979 had an annual premium of less than $200. The average premium on these policies was $115. These people need and want life insurance. They do not have the wherewithal to invest in money market funds or the stock market. They are aware and perhaps somewhat frightened of the uncertainties of our present economy. They want some security. That is why they still buy guaranteed cost life insurance from Allstate.

MR. RICHARD M. STENSON: My answer to the basic question, "will cash value life insurance as we know it continue to be viable" is "yes, probably"; or "probably, yes".

This firm answer is in light of the many circumstances accompanying the question described in the program. None of these tend to produce an optimistic attitude as to permanent insurance, so comment on some of them might be appropriate.

The economic situation is almost always uncertain, but the uncertainty of today as to the prognosis for continued double digit inflation and its impact upon people's ability and desire to save, and upon interest rates, is particularly important to cash value life insurance. The future could contain much higher interest rates than today, hyperinflation, economic bust and other developments either too horrible to contemplate - or about which little could be done should they unfold.

On the other hand, we could see a gradual return to more moderate inflation, a "right-side-up" yield curve (short-term rates below long-term rates) and healthy economic growth. This scenario is probably too good to be true.

A more likely near term result is continuing high inflation relative to historical levels, perhaps 7-9%, or in the low double digit area. Investment yields would remain high, as would the tendency of insureds to take loans. The tendency to increased policy loans has historically followed short term interest rates very closely. This is likely to continue, particularly with the proliferation of money market funds and bank instruments based on short term rates.

Yet, it is interesting that all policy loan values are far from being taken out. For 15 large companies at the end of 1979, the ratio of policy loans to ordinary reserves grew at a rate of 8% to 13% of the ratio at the end of 1978; but the ratios at year end 1979 varied from 10.7% to 38.3%; most of the companies being in the 20% and 30% range. Something like 70% of cash values went unborrowed. The question could well be asked, why has so little been taken out, rather than why are so much of insurance cash values borrowed. I believe the answer lies in several factors. First, inertia. People who think about investing loan values in higher yield instruments may simply not take the trouble to do so. A continuing high rate of outside interest may overcome this inertia.

Second, people may simply be disturbed about "impairing" the death benefit value of their life insurance.

Competitive term policies and "buy term and invest the difference" approaches certainly also take their toll in terms of the appeal of cash value life insurance, particularly with other attractive savings programs available. Some consumerists and regulators, including the FTC, have certainly added fuel to this fire. Nevertheless, substantial permanent insurance continues to be sold - - about two/thirds by amounts in 1977 and half by amounts in 1978. That is not to say, though, how much may have been sold under minimum deposit arrangements. However, there remains a real interest in permanent life insurance on the part of the buying public - or at least a continued willingness to buy!

Underlying these changes is also an undercurrent of sociological change, real or perceived. Smaller families, later marriages, more single parent family units, more two-income families, more interest in "self", more purchase of consumer goods, less desire to save and, perhaps until recently, more reliance on government - all of these are part of our national feeling. Nevertheless, there remain large numbers of people with responsibilities to children, now or expected later; businesses they wish to pass on to them; dependent parents; estate tax concerns; etc. The insurance market remains active, and one recent survey indicated about two-thirds of Americans regard insurance as much of a necessity as food, clothing, and shelter.

Part of the appeal of permanent insurance, I believe, is the simple fact that it will provide insurance for the whole of life. Agents are fond of pointing out that it is the only form sure to "pay off" if kept in full force. It does provide the customer holding the policy until death an effective inside tax free build up to maturity. Many insurance needs are or are perceived to be of permanent duration. Estate tax is one, and the recent combined estate and gift tax laws may act to promote the need for life insurance to families with substantial estates.

And even today, some people may not really feel good unless they are "saving". In a recent survey we made (1978), a substantial portion of households agreed that "cash value life insurance is an important way for me to save" - almost 40% agreed at lower income levels; still above 20% agreed at the higher levels. Interestingly enough, the same survey showed recent purchasers of insurance chose cash value plans 67% of the time at moderate income levels and 73% of the time at more affluent levels.

I should also comment on products, or modifications, that may seem particularly well suited to the current time. Variable life insurance products provide permanent life insurance protection, but with assets invested in a separate account. Equitable Variable Life Insurance Company's current Variable Life Insurance policy uses a common stock separate account. The return, with recent good experience, highlights the investment results of the account, which can be tracked by the customer separately. Other investment media could possibly be used for the separate account with such a policy.

These policies, besides capturing the attention of customers wanting permanent life insurance but interested in a particular investment media, also provide a mechanism for insulating the effect of policy loan disintermediation. In the Equitable Variable Life contract, loan interest is charged at 5% and the customer is credited a 4% rate on those amounts. In effect, assets corresponding to the loan are pulled from the separate account.

Other possible modifications strengthening permanent products could lie in changes in the treatment of policy loans on more conventional policies. The new variable loan interest model bill of the NAIC will provide relief in this area. This, of course, offers perspective relief only. There has also been considerable discussion over the years of the possibility of varying dividends on outstanding policies with 5%, 6%, and 8% loan rates according to loan utilization on an individual policy basis. I believe this is still rather questionable on legal grounds - although unquestionably it would be an equitable practice. There was one report of a company planning the practice, as I understand it, on a prospective basis with respect to increases in future years above the current aggregate loan utilization.

Replacement is a continuing fact of life in the middle of this and any other time. In our more conventional, high early year compensation products, the "front end" commission can be both cause and cure to replacement. It can represent to the agent an incentive to replace. At the same time, it produces a pricing pattern on the new product which makes the replacement - certainly, at least, in the early years - look bad to the customer.

I think this is the real dilemma, and again, it is not one limited to the current time. Single premium policies and deposit term may look particularly good right now, in some of these situations, because of high interest yields. However if the sales compensation on the replacement is at customary levels, the interests of the customer over the shorter term are not likely to be served well.

The real question, I think, posed by the dramatic changes in insurance products appearing to develop now may, in fact, go to the distribution system. The most effective way of marketing products, including in the case of products sold on commissions the level and incidence of commission, will really govern the industry 10 or 15 years in the future. These basic marketing decisions interacting with the economic climate will affect the industry for the longer term and govern the future of permanent life insurance.

There is a good, long-term prognosis for some form of permanent life insurance protection continuing to be very active in our marketplace. Even the traditional product is likely to have a fairly long life. Permanent life insurance can be simply thought of as a single instrument providing lifetime death benefit protection at a level premium, rather than as a combination of insurance and savings. It is often sold that way, often perceived by the customers in that fashion, and I think likely to remain with us in that form and many others for some good time to come. Thank you.

MR. ALAN RICHARDS: Question 1 on the program is very precisely worded:

> "Will cash value life insurance as we know it continue to be viable in light of certain factors?"

Since the operative phrase is "as we know it" the simple answer has to be "no". However, the answer to the question "does permanent life insurance in some form have a viable future?" may well be "yes, a very bright future."

Traditional whole life insurance is currently beset by a number of economic and social problems which appear to be overwhelmingly negative. Traditional whole life insurance might be defined as a plan of life insurance in which the benefit period is long enough to require the building of substantial cash values as a result of the payment of a level premium which in the early years is more than sufficient to cover death benefits. There is no formal separate identification of the pure life insurance portion of the contract and the cash value portion. (Acquisition costs are levied in substantial amounts on both insurance and savings components.) In the opinion of some, the cash value should be regarded merely as a consequence of the operation of the level premium principle.

However, traditional permanent whole life insurance has its roots in the 19th century and the early part of this century when the value of the dollar was reasonably stable; when the creation of money and credit usually proceeded at a pace commensurate with the growth in the economy; when policy loans were regarded as a somewhat expensive method of raising cash, and a privilege to be used sparingly; when term insurance was sold in very small quantities and then only to cover needs perceived as being strictly temporary; when alternative savings media might be risky considering the frequency of bank failures; when that awkward word "consumerist" had not been invented and when the income tax was 1%. You will agree, I think, that not many of those factors have remained unchanged in 1981.

Most importantly, that most subtly destructive phenomenon, inflation, was in a quiescent phase when traditional permanent insurance was in its heyday. The history of civilizations over many millennia has unfortunately shown that mankind must frequently relearn the lesson that inflation, whilst initially very seductive and seemingly reqarding, ultimately consumes its progenitors. By the 1930's, we had forgotten the lesson again and the foundation was laid for the creation of excessive money and credit, slowly at first and then accelerating to the present day.

However one may care to describe the structure of the traditional whole life policy, it is inescapable that by paying a level premium the policyholder foregoes the enjoyment of current income in the expectation of future reward. A cash value is therefore by definition a savings account whether we choose to call it that or not.

In an inflationary environment the saver will seek to place funds with a financial institution that can attempt to compensate through higher, current interest rates for his inflationary losses. That is difficult considering that taxes serve to reduce whatever interest is earned.

Unfortunately there are a number of reasons why the life insurance industry has been unable or unwilling, to effectively compete for savings in an inflationary era despite some intrinsic advantages.

First, the nature of the traditional whole life contract leads to the accumulation of large sums of money under long term guarantees. It was natural that the life insurance industry should become the principal supplier of long term debt to the economic system and to the great benefit of that system. This practice continued long after inflation became embedded in the economy; long rates which looked attractive when such investments were made would a few years later turn out to be less than current short rates. At the same time the companies experienced large market losses in long securities.

This circumstance would have made it difficult for a life insurance company to compete for the savings dollar under the best of conditions, but the blind insistence that we preserve the structure of the whole life policy as if Calvin Coolidge were still in the White House means that our industry cannot even begin to compete for the savings dollar on terms which the public understands.

We say to the consumer, "We are asking you to set aside current income for future enjoyment, but if you ask us what rate of interest we pay on those savings we have to tell you that is not a valid question. The structure of the traditional whole life policy does not permit us to give you an answer. Trust us." The natural human tendency to assume the worst in the absence of positive information is reinforced by the appearance in the policy of the very low guaranteed cash value and valuation interest bases.

Finally, the traditional form of whole life actually levies a substantial capital charge on the savings of policyholders in the first year or two. This is a unique and somewhat discouraging negative inducement to save through life insurance.

Is it any wonder that in recent years the public has flocked to money market funds, to CD's, to annuities which at least express a rate of return on a retrospective excess interest basis or to any other savings medium which describes its product in understandable terms?

It is, perhaps, surprising that so much traditional whole life is still sold. This is a tribute to the power of inertia and the dogged persistence of so many dedicated life insurance sales persons who frankly deserve to be served better by their companies. Yet, the life insurance business has some important intrinsic advantages. The so-called inside build-up which effectively defers tax on interest earnings should be an enormously powerful tool for attracting savings with consequent benefit to the economy.

A large and aggressive distribution system is in place and should be given the opportunity to sell a life insurance product with understandable interest returns which are presented on a retrospective interest accumulation basis. The percentage of the savings component of the premium dollar available for the distribution system must be reduced. However the revitalized attractiveness of life insurance as a repository for savings would go a long way toward maintaining income levels for the competent sales person.

Will this work? Can we make the transition? I believe we can. As evidence, we have the greatly increased popularity in recent years of low-load annuities; not only single premiums, but Universal Life type policies which combine an annual premium annuity with term insurance.

Our company took the next logical step and developed a life product based upon the separation of the savings and pure insurance components. This has some obvious tax advantages over the annuity plus term insurance approach. We call it Completelife. The savings component exhibits a competitive accumulation interest rate with clearly defined expense and mortality charges. There is complete flexibility with regard to premium payments, which helps identify the product with other savings media.

Until recently there might have been a question as whether such a product would qualify as life insurance under Section 101 of the Internal Revenue Code. However, we now have a favorable private letter ruling which sets the matter to rest.

Despite the outwardly different (and more attractive) appearance of the product, we were able to demonstrate to the IRS that Completelife can mathematically reproduce the traditional whole life policy. This is to be expected, since we are dealing with the essential equivalence of the retrospective and prospective methods of calculation.

So far the sales results have been extraordinarily good. Several companies are in the process of developing similar forms. Perhaps this approach may revitalize permanent life insurance.

The alternative -- an all term industry -- is not pleasant to contemplate. It probably could not support the overhead we have become accustomed to. There might be a massive consolidation of companies and a substantial shrinkage in the sales force. It is doubtful that there would be a need for as many actuaries as are currently employed by life insurance companies!

To summarize my message today:

1. The life insurance industry is firmly wedded to the savings business and has thrived upon it, even though we have been losing market share rapidly. The capital formation thus facilitated is of great benefit to the economy.

2. To deny that we are in the savings business in order to defend an obsolete product is totally counter-productive. This attitude could cost us our greatest strength.

3. New products which emphasize savings in an attractive, understandable way could again lead to a regaining of a large share of the savings dollar and reversing the present decline.

I suspect that one may be misled by some of the numbers that support the comment that perhaps permanent insurance is not declining as rapidly as we might think. Obviously, for one thing, the data ignores policy loans which are very definitely a form of disinvestment. Policy loans convert permanent insurance to term insurance with a large commission. There is a great deal of minimum deposit business. Our experience has been that perhaps, in a rather sophisticated market, very few traditional whole life policies are sold to the "upper crust," without being minimum deposited at some point.

MR. OVERBERG: The LIMRA statistics showed that 26% of industry sales are whole life. Whole life is defined to exclude limited pay policies, EOL policies, deposit term products and modified premium products, which I understand many companies call whole life even though the premiums are equal to ART rates. So it excludes those. Allen is right when he says that they include all whole life policies even though the cash value may have been borrowed.

MR. LAWRENCE SILKES: Mr. Overberg, I would like to hear your comment on two observations of your discussion. You stated that there is a future in permanent cash value life insurance, based upon the assumption that inflation will subside, and that traditional whole life products will satisfy the needs of the insuring public. However, if this were not a meeting of The Society of Actuaries, but a trade association meeting of the Savings and Loan Association, would you say that in these inflationary times, there is a future for the 5¼% savings account? In addition, you stated that the average premium for life insurance would be $200....with that $200 someone could buy $100,000 of life insurance.

MR. OVERBERG: The savings and loan business has some of the same problems and prospects as the "whole life" business. We must remember that there are millions of Americans who are earning much less than the average income in this room. I mentioned that 54% of the policies sold last year had an annual premium less than $200.

People who purchase small life insurance policies are generally people who really do not have the money and means to invest. Everybody should have a little money in the "cooky jar" that is convenient and easy to obtain. A Federally insured savings and loan is a good place for liquidity purposes for many people to keep their money.

MR. SILKES: Mr. Richards, you made a comment concerning the tax shelter of dollars under the universal life. I am sure you recognize the distinction between tax deferred under the universal life, where one must either die or surrender the policy to take advantage of the money, whereas, if one has invested in tax free municipal bonds, one has the use of the money while still holding the security and not paying a tax upon it.

MR. RICHARDS: You are absolutely right, but when purchasing life insurance it is assumed that there is a need for life insurance. If you do not need the life insurance, then obviously the municipal bond is a better buy for you.

MR. LARRY R. ROBINSON: Our industry's traditional role as a provider of long-term capital to the U.S. economy has been seriously eroded in recent times. It seems that "unbundled" products such as Hutton's Completelife exacerbate the situation. Would not a proliferation of these kinds of new money offerings mean only very short-term investments for the industry?

MR. RICHARDS: Investment in shortened maturities is not absolutely necessary when marketing products such as Completelife. This is a wiser investment philosophy in this kind of inflationary climate. I think you will find there has been a general movement toward shortening maturities regardless of the type of product being marketed. Most long-term investments provide for some kind of "kicker" or something which makes them somewhat inflation-proof. The trend is toward shorter maturities. Your own practice is influenced by your view of the future. If high inflation is to continue, shortened maturities are best. If a massive depression is to be experienced and interest rates are to fall drastically, the longer maturities are wise. We are faced with an investment philosophy question, and I am not sure it is one that is peculiar to Completelife.

MR. ROBERT C. TOOKEY: I am interested in modifications that can be made to existing nonpar policies to reduce the risk of replacement. For example, voluntarily reduce the premiums or, and perhaps preferably, increase the face amount while continuing current premium. What has been done, or what is contemplated in this area?

MR. OVERBERG: I can relate what our company is doing, and I would be interested in hearing from other stock companies. We are in a unique position. We are doing several things. First of all, we are monitoring replacements very closely. We have experienced some replacements, but in most cases our policy is replaced as a consequence of other policies being replaced. In other words, typically another company's large policy becomes the subject for replacement. Our policy will be replaced as part of the package. Secondly, we have been considering our older policies. As I indicated earlier, ours is a small policy market. That is our main market, and we have very few old policies that are sensitive to this issue. Our policy fee has been increased over the years, so the smaller policies are not subject to replacement because they have a lower policy fee than the current policy fee.

MR. KEMBLE: Does anyone else have any comments about the replacement problem, with particular emphasis on nonpar policies that have been in existence for a period of years?

MR. RICHARDS: I have a feeling that ultimately most companies will have to consider some kind of internal replacement. Keeping the business in force appears to be more attractive than having the agent of some other company replace that business with the ultimate result of having to sell securities at greatly depressed market values.

MR. JOHN O. MONTGOMERY: In California we have no replacement regulations. Most of the companies operating in California realize this is not by accident, rather it is a policy. The only times we are concerned with replacements are when there are unfair trade practices involved, and in those cases we will investigate. However, if we are dealing with a true replacement and the policyholder is in a better position with the replacement, the California Department believes that this is healthy and that the policy should be replaced.

MR. KEMBLE: John, do you have guidelines that indicate when the replacement is advantageous for the policyholder?

MR. MONTGOMERY: That has to be demonstrated if there is a controversy.

MR. JOHN A STEDMAN: I would like to address a question to Mr. Richards. Is the pricing of your Completelife product dependent on the effect of federal income tax? If so, how are statutory reserves defined and how are they treated in the tax return with respect to (a) the ten-to-one adjustment, and (b) the approximate 818(c) adjustment?

MR. RICHARDS: In all respects, it is treated as whole life insurance.

MR. ROBERT J. TIESSEN: A couple of Canadian companies have increased the face amounts on some old nonpar policies to help with the replacement problem. These policies have generally been fairly old, over ten years, and the volumes involved have not been too large. A question I would like to ask of Mr. Stenson deals with the policy loan. He said that interest credited to the variable life policy depends on whether there is a policy loan, and he discussed other situations which seemed to indicate that he felt that the existence of a policy loan should not affect the interest credited. There are some companies varying dividend interest credits on regular policies depending on whether there is a policy loan on the contract. Is there any legislation relating to this question, and what is the background for practices in this area?

MR. STENSON: Regarding our subsidiary's variable life policy, it is a unique contract with a separate account invested in common stocks. If a policy loan is taken out, that portion of the assets is not credited with the separate account result. It is credited with a four percent net result in the general account. This is a specialized policy. With respect to variation of dividends for policy loan activity, I am not aware of any company which is doing this. There is a written report about a company considering a prospective basis.

MR. ROBERT J. BOHN: Franklin Life has been using different interest factors in the formula of its current dividend scale for the loaned and unloaned components of the annual change in each policy's value beginning October 1, 1980.

MR. LYNN C. MILLER: Although Completelife cash values must be determined retrospectively due to the flexibility of premium payments, policyholder benefits and maturity date, the calculation of reserves requires a prospective approach if the company has made guarantees beyond the valuation date that are more liberal than the reserve valuation basis. As of any valuation date, the future benefits are a function of the existing cash value, future premium payments, future interest rate credits and future mortality charges.

Suppose that no future guarantees have been made with regard to excess interest or reduced mortality charges, i.e., future guaranteed interest is 4% and future guaranteed mortality charges are based on 1958 C.S.O. mortality rates. Then, by definition, the cash value on the valuation date is the proper reserve regardless of the future level of premium payments, death benefits or maturity date, provided the prior expense charges that were deducted from the gross premiums satisfy the constraints imposed by the standard valuation law. These constraints require that renewal expense charges must be a level percentage of gross premiums and that the excess of the first year expense charge over the renewal expense charge expressed as a percentage of gross premiums does not exceed $_{19}P_{x+1} - c_x$.

If the company has guaranteed future interest in excess of 4% and/or guaranteed future mortality charges less than the 1958 C.S.O. basis, the statutory reserve will exceed the cash value. The mechanics of the reserve calculation in this instance involves the projection of the current cash value to the point in time where guarantees revert to the 1958 C.S.O. 4% basis, and then the discounting of this projected cash value back to the valuation date using 4% interest and mortality charges based on 1958 C.S.O. mortality.

Hutton Life has filed an actuarial description with each state which develops the theoretical basis for the above approach in much more detail.

I would like to make a comment regarding the philosophy underlying our method of determining commission rates. The portion of the first year premium needed for mortality charges receives a commission consistent with annual renewable term commission rates. An additional flat per policy commission is paid. Any premium in excess of that required for mortality charges and first year expense loads becomes cash value and receives a much lower commission consistent with the rate typically paid on single premium life insurance. Thus the overall commission rate expressed as a percentage of premium reduces as the level of first year cash values increase. This approach results in a more consumer oriented product since cash values will build more rapidly when compared to the traditional permanent product where virtually all of the first year premium is fully commissioned.

Hutton Life is convinced that Completelife and products similar to it should improve the insurance industry's ability to attract savings dollars.

MR. OVERBERG: I might mention that I said 54% of the policies sold in 1979 have less than a $200 annual premium. Also, 82% of the policies had less than a $400 annual premium; so, $1,000 annual premium business is a small portion of the total market.

MR. MILLER: We have been quite surprised with the average premium on our policies.

MR. OVERBERG: Do you have any idea how many of your sales are replacement sales?

MR. MILLER: We have not tabulated that ratio, but we certainly have some replacement activities.

MR. RICHARDS: Perhaps the key factor is not the proportion of the business that has less than a $200 or less than a $400 annual premium, but the fact that the large policies have tremendous weight. A great proportion of the premiums, reserves and cash values could come from larger policies, which is the market we have been losing. The larger amounts have been written with term insurance or have been minimum deposited.

MR. THOMAS F. EASON: My question is addressed to Mr. Overberg and to Mr. Stenson. The question has to do with marketing. The Unruh special committee report dealing with nonforfeiture was published several years ago. There is a good deal of discussion in that report about nontraditional products -- products that change their course in midstream, and in fact, the new model nonforfeiture and valuation law allows for an alternative to approve such nontraditional products. In Allen's presentation, he discussed the impact on field compensation. If, in fact, this type of product leads to a very competitive design and to an understandable product by reducing the compensation to the traditional writing agent on the order of 50% or more, what are the prospects for the larger companies, such as the two represented here today, for moving into this product line, or have we already done so through combinations of annuity and term sales? What will be the impact on the field force? What structures will develop to allow larger companies to market the product if they feel they must join this new, competitive design?

MR. STENSON: You have raised the basic question for the marketing of individual life insurance; namely, what is the right way to sell the product and what is the right compensation level for the agent, both in total and incidence. A product whose price is improved by, among other things, lower commissions may not be widely used by our agents. If the agency force system remains an effective way to create business, then the more traditional forms of products and compensation systems will survive. If a different, lower compensation level requiring agents (if an agency system is the mechanism to sell the policy) to collect greater amounts of premiums is effectively executed through this product or other products, then I think the big companies must consider developing them. I do not have any specific answers as to how one might change a product to make it more competitive in this market. Obviously, many of us will be required to start thinking about it.

MR. OVERBERG: When Jim Anderson first talked about Cannibal Life in 1975 at the Pacific Insurers Conference, I lost sleep for two weeks wondering whether Allstate should adopt this concept. There are several reasons why we have not done so. First, the big initial payment is a stumbling block. We had considered mutual funds having a minimum requirement of $300, but our agents could not solicit $300 from their customers to start a mutual fund. So, we did not feel we could succeed with a Completelife-type product. Also, our agents realize only six percent of their income from personal life insurance, and because our market is the small policy market, the amount of life insurance does not threaten us. We are concerned about the replacement problem. This product, as opposed to deposit term, is a good deal for the customer. It is hard to say something bad about Completelife. However, we do not think we need the product today.

We have been selling from Sears' booths for many years now. This month we will celebrate our 50th anniversary in the casualty business. We have 24 years of experience in life insurance. Very few people walk up to a booth and ask to buy a life insurance policy. Our agents spend only half of their time behind that booth. When they are not busy taking somebody's application on auto or homeowners insurance, they are on the phone trying to solicit life insurance business. The other half of their time is spent in the "kitchen" trying to sell life insurance. Our agents try to sell life insurance in conjunction with their other sales activities to permit them to afford to sell it.

MR. RICHARDS: If we make it more attractive for people to save money through the life insurance mechanism, then the problem Tom Eason mentioned, which is how do you compensate the agent when the per-unit compensation is less, will solve itself. Think for a moment how much money market funds could be sold if a 40% first year load is charged? How much saving would be attracted to a savings and loan if the first years savings deposits are reduced for commissions? We simply do not have something that attracts people to save money. If we make it attractive for them to save, the salesman, while being compensated with a much smaller proportion of the savings dollar, will realize much more preserved income.

MR. VERNON J. SMITH: We have had much discussion about various products which will help the insurance industry maintain or increase its share of the investment dollar. In 1980 and for some years before, the tax-payer could receive $200 of dividends tax free on his joint return. In

1981, the taxpayer will be able to receive $400 of dividends and/or interest income tax free. There is even talk of increasing this to $1,000.

My question is what, if anything, is the insurance industry doing to be included in such a plan? If nothing, our share of the investment dollar will surely decrease. Also, we might recommend a deduction on premiums for the individual who buys permanent insurance - say up to 3% of his/her gross income.

MR. MONTGOMERY: The California Department of Insurance held an informal hearing on February 26, 1981, concerning products like universal life or Completelife, which incorporate the retrospective method of accumulating surrender values. The policy of the Department is to allow any insurance product to be written if it will not impair the financial stability of the insurer, if it can be understood by the public and if the benefits are reasonable in relation to the premiums or considerations charged. If such products do not come within the strict confines of the standard valuation and nonforfeiture laws because of their nature and if all of the other criteria mentioned are satisfied, then the product may be written on an experimental basis, possibly with special reserve and/or reporting requirements depending on the nature of the product.

With respect to indexed products for which funds are accumulated at a rate of interest which is guaranteed for less than a period of one year, but which is also guaranteed to equal the value of some index such as the United States government 90-day T-Bill rate or a specified percentage of the prime rate, the Department will require that the assets relating to the funds accumulated on such plans be allocated, either in a separate account or as an allocated portion of the assets in the general account, so that the yield on such investments during each reporting period can be compared with the interest rates guaranteed for the accumulation of funds during the same period. If the margin of the investment yield over the guaranteed rate of interest falls below a specified level, additional reserves or contingency funds may be required.

The California Department has not yet issued a bulletin or promulgated a regulation on such business and prefers to wait and observe what is happening to the products now being written and also to observe any further new products of such nature.

Since California does not require prior approval of new policy forms it is suggested that any insurers contemplating the writing of unusual new products in California contact the Chief Actuary of the California Department. This will save such insurers much expense and time, particularly if the Department disagrees with some of the provisions of the new product. The California version of 1980 valuation and nonforfeiture amendments will include this filing requirement but will not mandate that the Commissioner be required to either approve or deny approval of such forms. The purpose of this requirement is to save product development expense for the insurer and to provide guidance to the insurer in uncharted waters.