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THE BLURRING OF THE LINE BETWEEN GROUP AND INDIVIDUAL INSURANCE

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1. Fundamental differences
   a. Experience ratings vs. guaranteed rates
   b. Selection

2. Marketing Concepts
   a. Small vs. large employer groups
   b. Associations
   c. Mass marketing
   d. Creditors insurance
   e. Emerging marketing approaches

3. Product Competition
   a. Term life disability, annuities
   b. Investment products, tax considerations
   c. Combination sales
   d. Flexibility and portability
   e. Other emerging products

4. Underwriting costs
   a. Select vs. aggregate mortality
   b. Simplified evidence requirements
   c. Maximums, exclusions
   d. Expenses

MR. ALAN W. SIBIGTROTH: This session will focus on the blurring line between group and individual insurance. First, we will give you a background of where group and individual insurance traditionally have been. We will explore the blending of markets, products, and company operations on both sides of the house.

The panel members will discuss these aspects from the group insurance, the individual insurance, and the reinsurer's perspective. Due to the specialized expertise of these individuals and time limitations, we will focus our discussions on life insurance.

BACKGROUND - POINTS OF DEPARTURE

Generally, individual insurance has been characterized by either medical or non-medical underwriting. An individual, in most cases, has to support that he is a standard health and financial risk on his own, and if he is not eligible for this classification, he is charged an additional premium relating to his extra hazard. In the past, non-medical insurance, when it was available, was issued for fairly low amounts, in the area of $30,000 to $50,000. Group insurance, on the other hand, is identified by a different underwriting standard that stresses a balance and a spreading of risk. A primary group insurance consideration is that the individual be actively at work at the time he becomes eligible for the insurance. In most cases, this is the only basis on which to rescind a claim.

Other underwriting characteristics are:

(1) A reasonable relationship between the benefit schedule and salary or job classification,

(2) The amount of insurance should not be selected by the employee,

(3) A minimum number of employees is covered. At present, this minimum is 75% for contributory plans and 100% for non-contributory plans.

Individual coverage has generally paid higher commissions, reflecting the greater effort required to sell an individual policy. Individual commissions to a soliciting agent run about 40% to 60% of the initial premium. On the group side, commissions can be far less, as low as a fraction of one percent of premium on large cases.

The primary market for group insurance has been an employer with the desire to provide a basic layer of insurance protection for his employees. The common benefit is a flat benefit by class or some multiple of salary - usually 1 to 3 times annual salary. Individual coverage is generally tailored to the specific needs of a business or person. Personal needs include income preservation and estate creation. In corporate sales, individual coverage is used for buy-sell arrangements and to structure specialized bonus and deferred compensation plans to key individuals, but usually on a very selective basis.

Group and individual insurance are covered by separate regulations of the state insurance departments. Because of these regulations, group insurance does not have the proliferation of policy provisions required for individual policies, and group premium rates are not guaranteed, except perhaps for a few years after issue, making possible more aggressive pricing. On the other hand, individual premiums and cash values are guaranteed.

Individual pricing historically has been pooled by broad dividend categories. Group insurance pricing may also be pooled, but on larger cases it can and often does trail the experience of single group cases.

TRENDS

We have witnessed the use of group programs in areas traditionally reserved for individual sales. For example, flexible benefit schedule group plans are becoming common for cafeteria styled insurance programs, allowing the individual to select the amount of insurance. We can expect to see a good deal more of this as pro-competition, the employees right to select his own benefit program, becomes more popular. Generally, group programs are offering greater flexibility and portability of life insurance coverage, as in franchise insurance, for example. Individual coverages have also seen change. We find wider use of the group multiple employer trust where policies are issued either to small groups or to individuals. Examples of this are single premium and deferred annuities.

Perhaps the key change has been the use of simplified issue and guaranteed issue for individual policies at very high amounts (in the area of $250,000 to $500,000 face amount), while at the same time, group insurance, with increasing frequency, requires medical or non-medical underwriting, particularly for voluntary insurance programs.

The pressure on premium rates and values in recent times has forced term premiums to new lows. Non-par term premiums are now more common to individual life product design. The need for more competitive interest earnings has created an array of products that appear to be like group term with a side fund. Federal Income Tax and policy loan considerations can be just as important as policy features in the decision whether to design a concept as a group or an individual product.

We will explore the subject first from the group insurance perspective, then from the individual side, and finally, we will see the reinsurance viewpoint. The panel will then accept questions.

MR. DENNIS J. WHIMPEY:

I) BACKGROUND

Group life insurance was introduced about 70 years ago. For many years thereafter, group life insurance was limited to large and medium size groups. It offered moderately uniform amounts and simple term plans. In the recent past, there have been two main forces moving group and individual closer together: the downward extension to smaller and smaller groups, and the development of more complex products which can be tailored to individual employee needs and permit individual employee choice.

Specifically on the drift downward in group size, for many years my own company's definition of a group was 25 or more lives. About 25 years ago, that definition went to ten lives, and about six years ago, the definition went to two lives.

As far as products are concerned, we now write such products as survivor income, group permanent life, and dependent life insurance. The combination of such products in a structure that permits layering, employee choice, and employee contributions (or employee-pay-all plans) gives great flexibility.

Why has there been this sort of movement in the group insurance line? One could submit a virtually endless list of reasons, but four main ones are: (1) the perceived need for improved employee protection, (2) the efficiency and low cost of the group approach, (3) the continual union pressures associated with the post World War II employer tax incentives, and (4) the continued aggressive marketing of group products by insurance companies.

Just as group insurance flexibility has allowed sizes of covered groups to contract, individual insurance flexibility has started to expand. My company now has individual insurance policies designed to be sold efficiently at low individual rates to employees of our group clients, which is another example of blurring.

II) MARKETING AND DISTRIBUTION

What are the needs of the purchaser, and what are the needs of the marketer? For group life, the purchaser is a representative or a committee of a corporation or business. In large corporations, the criteria for selecting group plans, and the market need that must be met by the providers, tend to center around such things as competitive benefit levels and employee satisfaction with both the substance and the communication of the group insurance program. The provision of benefits must be at a cost acceptable not only to the benefits people, but also to the financial people. Finally, maximum use of tailor made plans can be made through designs developed by the benefits committee of the corporation, by the insurer, by consultants, or by some combination of them.

The focus in the small group area is a little different in that small corporations are generally controlled by their owner or a small group of owners who have personal interests that must be satisfied through the selection of a group life insurance plan. Also, there cannot be as much custom tailoring, or quite as much imagination, thus producing interesting problems to be addressed.

The primary period of protection that is of interest in the group insurance market is the working lifetime of the employees; however, there will be increased interest in the post-retirement situation. When the retiree force covered by the continuation of insurance was small and was not increasing as a percentage of the entire covered population, little attention was paid to post-retirement benefits. This view is changing for both large and small groups, and we will be seeing an increased movement toward attending to post-retirement needs, both in terms of protection of the employer from unacceptable cost, and in terms of protection of employees through some continuation of group coverage.

As far as the needs of the group marketer, the insurance company, are concerned, there is some difference between large groups and small groups. For large groups, the key to successful marketing and maintenance of cases in force tends to be on the development of good relationships with brokers, consultants, and the clients themselves, with an accent on the efficiency of the distribution - efficiency in terms of accurate and timely claims payment, low administrative cost, and innovative funding arrangements.

For small groups, by contrast, there is much more of a one-on-one aspect in the sale, involving in most cases agents who work with the purchaser/owner in a very personalized relationship. This bears much resemblance to the one-on-one sale of individual life policies.

In our own company's perspective on the distribution system, we identify three size categories: First, for very large groups (2500 or more lives), the accent is on service and consulting by the insurance company. This function, we find, is well handled by salaried account executives or account managers. Second, for the medium large group (150 to 2500 lives), the accent is on service, but also on sales. For this intermediate band, we use sales representatives who are partially salaried and partially incentive compensated. Finally, for the small group (2 to 150 lives), we market through agents on a commission basis. This is where the distribution system causes an interesting competition for the time of the agents - whether to sell individual, group, or a combination of the two.

III) PRODUCT DESIGN - UNDERWRITING, PLAN CHOICE AND PRICING

The focus here will be exclusively on the small group. We have specific underwriting guidelines for our small groups, to which we require strict adherence, to obtain satisfactory underwriting results. For example, we have four requirements for an eligible group: (1) an employer-employee relationship, (2) financial soundness, (3) year round operations on an expected permanent basis, although we recognize that there are many small businesses that rise and fall each year, and (4) a relatively stable employment force. Although we market to as few as two lives, we do not consider a husband and wife to be an eligible group. We restrict eligibility to full time employees, where full time is defined as regular employment of at least 20 scheduled hours per week.

We do have some life underwriting exclusions for groups of less than 50 lives. For example, we will not take amusement parks, diving operations, foreign embassies, and other groups of this sort. For accidental death and dismemberment insurance, we have a few more exclusions for such groups as demolition derby employees, workers who wreck with ball and chain, those who work with explosives, and miners.

Within the small group spectrum, by lives, we do make some further distinctions, particularly in terms of requirements for participation and evidence of insurability. For groups of 4 or fewer lives, we require 100% participation. For groups of 5 to 25 lives, we require 80% participation, and for small groups with over 25 lives, we require the usual 75% participation. In terms of evidence of insurability, for groups with fewer than 10 lives, we require satisfactory evidence for each insured person. Usually, a statement of health is sufficient, but if that turns up any questions, additional requirements may be necessary.

By contrast, for small groups of 10 or more lives, we have somewhat more liberal underwriting requirements. Hence, we define for each group a "basic" guaranteed insurance amount, at a graded scale, which for instance, is $25,000 for 10 to 40 lives, going up to $50,000 for 40 or more lives. These basic amounts apply to employees under age 60, with a sharp grading downward for employees over age 60. Amounts of insurance in excess of these basic amounts are available but do require evidence of insurability on an individual employee basis.

In terms of the type of plans that can be written within these amount and insurability criteria, we offer flat plans, class plans, and earnings plans. The flat plans go from $5,000 to $20,000, in $1,000 increments. The class plans permit 2 or 3 classes for groups under 10 lives, and 2 to 4 classes for groups of more than 10 lives, with a satisfactory relationship required in going from one class to the next class. In any event, the overall limit on class plans is $50,000. The earnings plans for small groups are 1, 1 1/2, or 2 times salary with a maximum of $50,000 for under 10 lives and a maximum of $100,000 for 10 or more lives. So there is a sense of blending in going from the small end to the large end of the spectrum.

IV) THE FUTURE

I would like to conclude by looking into the future to predict the kinds of things that we might see, in what will be a continuation of the process of blurring. Two areas will be examined: First, the large group, where the emphasis will be on product blurring, and second, the small group, where other aspects will be emphasized.

In terms of the large group, the major aspect in a blurring context is the continued expansion of individual employee choice within the group. There is a developing trend toward giving employees the opportunity to elect different amounts of insurance or different product mixes at various times in their working career, as for example, on marriage, birth of a child, or other defined events. As I alluded to before, we will also see increased interest in the provision of post-retirement group life benefits on some basis that balances cost to the company with appropriate insurance amounts. This may involve some pre-funding in which the employee takes part, in group permanent, or in application of funds that have been accumulated under a thrift plan to purchase post-retirement coverage at or near retirement. We will see increased tailor-made executive supplemental benefit plans, and increased coverage in the dependent life area. All of these, from the individual point of view, are an encroachment into traditional individual territory, and from the group point of view, they are wonderful and inevitable.

On the small group side, the focus in the near future is likely to be on greater efficiency to compete with techniques such as mass marketing of individual products. I see greatly strengthened decentralized EDP operations, which, for example, will permit the instantaneous remote issue of proposals, so that the agent can get back to a hot prospect before the prospect cools down. I see use of such EDP systems in the prompt issue of policies, at low administrative cost, and in the maintenance of small group policies, as, for example, in the premium billing and collection functions.

Finally, I see three other things: the first is an evolving distribution force that must become more efficient. The second is the further development of the underwriting area for small groups, to keep up with and perhaps to keep ahead of the liberalizations that are taking place on the individual side of the house; and the third is an increased sale of specially designed individual policies to employees of groups.

MR. DAVID P. VANDERSCOFF: Three years ago, in mid 1978, Northern National Life Insurance Company developed its Multiple Acceptance Program, involving the marketing of individual policies in a group environment. Multiple acceptance includes guaranteed issue business, meaning no underwriting, and using only an actively at work question, and simplified issue business, covering the gamut between guaranteed issue and full, medical underwriting.

We developed this multiple acceptance program primarily to enhance our sales by attempting to reach new markets that we had not previously entered by using regular individual underwriting with individual products. We felt that there could be extensive savings of time and effort by our sales force and expense savings in underwriting and issue of policies if we could sell individual policies on a group basis.

Our program started with the availability of guaranteed issue using individual policies, using only the actively at work question, "Are you currently active and working full time?" We attempted to follow basic group underwriting rules in order to control the anti-selection which was expected. The availability of guaranteed issue inevitably generates a significant amount of interest from agents who have clients who are highly substandard or uninsurable. We felt that it was necessary to exclude these lives from the program, if possible, due to the obvious mortality risk, and potential insolvency of our small company if we received a preponderance of this type of risk.

It was imperative that we obtained additional protection by reinsuring a portion of each risk that we issued on a guaranteed issue basis. Since the program was new, we moved slowly, and kept in constant touch with our reinsurer by reinsuring part of each case on a facultative basis.

We needed an education process for our Home Office staff, particularly for the underwriters, marketing people and other administrative staff, but there was also a definite need to educate our field force so that they would become aware of how to market this type of business and that it would not be Northern National's intention to "give the business away". We do not believe in loss leaders or in introducing programs in which we expect to lose money.

Since guaranteed issue business is potentially very dangerous if not carefully controlled, it was necessary for us not only to educate our field force, but to utilize moral suasion in convincing them that it was in their best interests to act in the company's best interests, that is, to avoid the highly substandard and uninsurable risk. This was especially difficult since most of our business is in the brokerage marketplace.

On our program's initial thrust into the multiple acceptance marketplace, we issued, on a guaranteed basis, 10 or more lives with a maximum of $100,000 per life (50% of which was reinsured), using a schedule of insurance of not more than 2 times the next lower class. From there, we evolved into our current four part program. It involves:

(1) Simplified issue using full non-medical applications on as few as 2 lives, and for as much as $300,000 per life,
(2) Simplified issue for amounts of $150,000 per life or less using a short form non-medical application involving four questions on heart disease, cancer, kidney disease or diabetes, and hospitalization,
(3) Guaranteed issue for 5 or more lives, with 2 or more lives having permanent insurance, and a maximum of $30,000 per life, and
(4) Guaranteed issue for 10 or more lives with insurance amounts equal to $10,000 times the number of lives or 20% of the overall case, whichever is less, with an overall maximum of $250,000 per life.

This seems somewhat complicated, but in actuality, after people work with the program for a while, it becomes relatively routine.

We found that our actively at work question did not have sufficient underwriting value in the guaranteed issue marketplace, especially in those situations where the general agent and broker did not actually see the client. Therefore, we revised our guaranteed issue question to: "Are you currently actively at work at least 30 hours per week, five days per week, at your regular place of employment, having experienced no interruptions from this employment for medical treatment during the 30 days prior to the signing of this application?"

One of the multiple acceptance areas where the line has blurred between group and individual insurance involves employer-employee groups with 100% participation, with all members of a defined class of employees being insured. Our guaranteed issue program has been successful in insuring the top class of employees for several "Fortune 500" companies. In addition, our simplified issue program has been successful using limited employee participation, as low as 30% with 500 or more lives, with specified schedules of amounts.

In 1978, when Northern National's Multiple Acceptance Program was in its infancy, its percentage share of our business was not significant. In 1979, multiple acceptance accounted for 35% of our business. In 1980, it dropped to 30% due to the fact that our field force tended to work with the larger cases which took much longer to develop. In 1981, multiple acceptance sales are now more than 50% of our total new business.

At this time, I see many companies entering the multiple acceptance arena, in particular, the non-qualified, individual product in a group environment market, which was previously considered to be forbidden ground because the risks were believed to be indeterminably large. I believe this has come about due to the growing trend of maximizing sales and minimizing effort through economies of scale. Also, the economic crunch has made it inadvisable for the agent (and the company) to stress "low ticket" individual sales, unless sold in a group environment.

There have been some specially designed individual products for the multiple acceptance market which involve higher premiums, lower commissions, and lower dividends (if applicable). In the employer-employee marketplace, many companies are beginning to use their regular products for multiple acceptance, with their regular premiums and regular commission scales, which I feel is extremely dangerous. At Northern National, we use our basic products, but we increase the premium to full net level premium for those products which have deficiency reserves, plus we reduce the commissions for all products in order to partially offset the anticipated extra mortality.

Special products or product lines are also used in salary savings programs where there is individual selection by the applicant in a group environment. Some of the salary savings programs offer guaranteed issue for as little as $1.00 per week, but introduce some medical questions when desired amounts exceed the maximum guaranteed issue available.

As we have seen, direct mail solicitation of life insurance has increased in recent years, and is now being offered to wide classes of people, such as for all holders of a particular credit card. The full extent of direct mail and mass marketing is still to be explored, but the potential is virtually unlimited. The solicitation of insurance using individual policies can be expanded to all reasonable groups formed other than for the purchase of life insurance.

The emergence of this type of business satisfies many needs. It makes it easier for the client to obtain insurance without excessive time delays or the effort required to obtain a medical examination. It makes the job of the agent somewhat easier because he can potentially sell large numbers of policies through one solicitation. The insurance companies are becoming involved because it is a relatively new marketplace, with virtually unlimited potential, involving the rather significant differences between group insurance and individual insurance sold in a group environment. For example, group insurance normally ceases after employment, whereas individual insurance can provide lifetime protection and is entirely portable when the employee leaves the group.

Terminating employees must normally convert their group insurance or lose it, whereas individual insurance can remain in force by paying the premium. The group insurance rate structure often fluctuates depending upon the group's experience, whereas individual insurance normally provides a fixed rate schedule, independent of experience (except for par policy dividends). With today's low cost individual term insurance, rates can be as low as those of group insurance, if not lower in some situations.

Group insurance normally does not provide settlement options other than those currently in effect at the company, whereas settlement options are guaranteed with individual policies. Commissions are often quite low for group insurance but are substantially higher for individual insurance, even if the commission rates are reduced to offset the extra mortality.

As I mentioned previously, there is a required training process for the Home Office and field personnel which is necessary due to new techniques resulting from a blending of individual products into a group environment. The marketing staff must be trained to educate the field force in new sales techniques. Different types of sales literature and promotion pieces are needed for the agent and client. Extensive effort must be made to promote greater awareness of the impact of mortality on the company's solvency. Underwriting personnel who are used to the extensive underwriting of individual policies must be trained in group techniques and must be carefully monitored so that they do not develop the syndrome of "giving the business away" as they adapt from individual to group underwriting.

There will most likely be greater claims activity, especially in the guaranteed issue area, where the claims investigation must be more intensive and acute. Often the only basis a company can use to deny a claim or prove fraud is the actively at work question. It is very difficult to prove that someone who owns a business or is in a top management capacity is not actively at work almost all the time. That is why we restructured our actively at work question - to avoid the problems which we saw evolving during the last few years.

Hopefully, with our new guaranteed issue question, a reduction in commissions, and slightly higher premiums, we will be able to offset much of the extra mortality caused by guaranteed issue. There are additional expense savings, of course, in underwriting. These savings can be quite extensive, such as elimination of medical exams, attending physician statements, inspection reports, EKG's, X-rays, and the like. Thus, the savings can amount to several hundred dollars, which offsets a substantial amount of mortality at the younger ages, but a significantly lesser amount at the older ages.

With respect to the future, I see the line between group and individual insurance blurring even further, as mass marketing techniques and programs improve and are expanded. Perhaps all policies, even those individually underwritten, will be issued on a group sales basis in the future. By using a group trust vehicle with relatively level commissions, much of the issue and printing expense of individual certificates could be eliminated. There could be additional expense savings if all policies were of a like kind, whether they were individual or group policies.

In the distant future, five to ten years hence, all policies and certificates could be eliminated. With the evolving trend toward extensive computerization and electronic transfers, the policyholder might eventually receive only a computer statement indicating the amount of coverage and benefits, accompanied, of course, by the usual computerized bill.

MR. GERALD A. LEVY:

Management Perspective and Considerations

Consider the basic forces underlying the blurring of the lines: Competition is all pervasive. It affects each of the major functions - marketing, underwriting, pricing, and administration. It has forced the price of some individual term plans down to below the levels of similar group products. Competition is also enlarging the market for mass marketed products. Both group and mass marketed programs offer large amounts, which heretofore were the domain of individual programs.

Mortality improvements have occurred through the early and middle 1970's at a rate of about 2 to 2½% per year. This, combined with competition and inflation, has added to the pressure to reduce underwriting requirements, especially on the individual side. It results in an enlarged standard class.

If both are available, should an insurer issue a group policy or individual policies? There is a natural competition within a company for growth. Perhaps political considerations will determine which product is used, or perhaps the guiding force will be such practical elements as the ability of the insured group to perform administrative functions, the degree of individual underwriting required, competitive cost considerations, or the source of the business.

Marketing - Direct Mail

Selling insurance successfully through the mail takes considerable expertise. About 15 years ago, some direct solicitations for life insurance produced response rates up to about 3%. Increased competition in this market has caused the response ratio to drop to low levels, until currently it is well below 1%. The best purchasers are those who have previously bought insurance through the mail. Direct marketers try to "load up" by selling additional amounts to existing clients. They have also had considerable success with "cross solicitation". Experience shows that buyers of one type of insurance coverage through the mail are the best market for sales of other forms of coverage. One company's recent experience selling from a "cross solicitation" list for the purchase of term life received a response rate of over 5%. In this age of computerization, a mailing list can be screened in many ways to produce a group with the characteristics one seeks. For example, it can be broken down by age, family mix, and socio-economic background. Because acquisition costs are high, as much as $200 per 1,000 letters mailed, the effort applied to screening mailing lists pay off.

A major retailer recently reported on its system of screening. It uses correlation techniques - matching the characteristics of those responding positively from test mail solicitations to those not responding. It develops a profile of individuals who are more likely to give a positive response. It then screens its charge customer file to create a select file of those persons with the favorable characteristics. After designing and testing one or more insurance packages, the big mailing takes place, possibly involving millions of letters. In today's competitive environment, an average response is about 1/2 of 1%. If responses fall below 3/10 of 1%, the program probably will fail. If an average response from a one million letter mailing is received, you now have the task of processing 5,000 applications, almost all of which arrive within a short period of time. How do you handle it? Speed underwriting and issue are essential to follow through on such programs. The longer it takes to issue the policies and collect the premiums, the lower will be the paid ratio.

Direct mail marketing may be done with individual policies or a Group Master Trust. It may involve modest insurance amounts (as under student programs with accept or reject underwriting), or it can be for substantial amounts, (as to professional people, with modified underwriting) up to $500,000.

Underwriting

Amount limits have increased significantly. Not too many years ago, medicals were called for above $50,000, even at the younger ages. At the older ages, all business was medically examined. Now, non-medical limits at the younger ages range up to above $150,000, and at the older ages, to around age 65, the limits are up to $50,000. Some aggressive companies go substantially higher. One such company uses non-medical limits up to $500,000 without age restriction if a comprehensive medical exam has been performed within the past year.

The blending of group and individual underwriting is most evident in mass marketed products. Many of the typical group underwriting safeguards are not present. For example, there can be individual selection of a benefit by the insured from among several options. The purpose of the group may be only for the purchase of insurance. Participation in the program is often considerably less than the minimum of 75% found in group insurance. Frequently, participation is well under 5%. Often there will not be an in-flow of younger new entrants to stabilize the average age. Thus, the underwriting standards for such business differ significantly from those of group. Modified individual underwriting is used with short form non-medical applications and Medical Information Bureau checking. Frequently, guaranteed issue amounts are offered under mass marketed programs. The limits are dependent on the participation experienced and other underwriting characteristics present.

The Reinsurer's View

From the reinsurer's perspective, there would be a need for risk sharing when substantial guaranteed issue limits are offered. In today's marketplace we frequently find guaranteed issue limits of $300,000 or more. Reinsurance can help a direct insurer compete for cases at guaranteed issue amounts above its normal retention. In such instances, agreement is reached between the direct insurer and its reinsurer about the guaranteed issue amount and the rules it will use. Any case differing from these rules could be discussed, and possibly accepted on a facultative basis. Further, amounts in excess of the guaranteed issue limit can be issued with full evidence.

Generally on mass marketed coverages, a reinsurer will set a price in expectation of higher mortality when reinsuring on an excess of risk basis. The differential reflects anti-selection on larger amount purchases. In one mass marketed program, mortality on policies over $150,000 was 20% higher than those below it. Also, the need for financial risk sharing may be present in direct mail mass marketing programs. Heavy mailing and other acquisition expenses can cause significant surplus drain. Such programs may require relief assistance from a reinsurer. If companies compete for mass marketing products without the benefit of prior experience, it suggests a quota share reinsurance relationship, thus providing both reinsurer and direct insurer with similar results.

To conclude my remarks about reinsurance, I would like to quote from a letter submitted to our chief underwriting officer from a client company. The letter included this paragraph:

> It has occurred to me that perhaps inflation will continue well into the 80's, and it becomes increasingly difficult to keep medical underwriting expenses under control. In this regard, I am suggesting the following guidelines in obtaining medical requirements on re-entry of our term portfolio: For re-entry at the end of the fourth year, up to age 45, $500,000 non-medically, but with an attending physician's statement; at age 46 and above, $500,000 with an attending physician's statement which includes an EKG. Incidentally, our other reinsurers are willing to follow what is being proposed.

Once we received information that our competitors went along with this liberalization, we had little room for discussion. This letter exemplifies the pressure facing reinsurers. It reduces individual underwriting requirements. Responding to both competition and inflationary pressures should thus be handled very carefully.

The Future Outlook

Competition for the savings dollar from the variety of existing financial organizations will intensify in the 1980's. There will be continuing emphasis on low cost term life insurance. These factors will make it increasingly difficult for the current large number of individual agents to make a living exclusively by selling life insurance. It will cause a substantial decrease in their numbers, encouraging companies to develop other forms of distribution, such as mass marketing. There is an analogy in the current environment to the demise of the industrial agency plant in the 1950's and 1960's. It will move life insurers to seek affiliations for one stop financial shopping. A number of companies have been successful marketing both casualty and life products. Others have had successful affiliations with securities brokerage firms. As company groups move toward becoming department stores for financial services, it will lead to simpler products, simpler and more liberal underwriting rules, and higher amount limits. Guaranteed issue amounts have been increasing. In a few years we shall routinely see guaranteed issue amounts at $1 million or more. Such amounts are currently available for retired life reserve wrap around products. Such high limits can have unintended underwriting risks. A $1 million guaranteed issue post-retirement benefit may involve costly speculation with the insured. An insured who is currently uninsurable has little to lose. If he dies prior to retirement, someone receives his premiums, accumulated with interest, tax free. If he dies after retirement, his beneficiary receives the full insurance benefit. Structuring products with appropriate amount limits and underwriting rules to avoid such hazards will test the skill of actuaries and underwriters.

Universal Life products will be in the marketplace of the future for both individual and group. These products can serve the insurance buying public's many needs. Several companies are sucessfully mass marketing such products now. It can be an all inclusive group vehicle. Under one umbrella, it provides flexibility to cover many different insurance needs: pre-retirement death benefits, a funding mechanism for post-retirement benefits, and possibly capital accumulation features.

MR. SIBIGTROTH: On the subject of reinsurance, I would like to ask Dave Vanderscoff about the type of reinsurance arrangement he has worked out for his multiple acceptance and guaranteed issue program.

MR. VANDERSCOFF: Initially, when we were getting into the multiple acceptance area, with guaranteed issue, our reinsurer was also new in the business, so we took a look at each case on a facultative basis and tried to underwrite it using group techniques. Most of the time we reinsured 50%. If it was an especially good case, we would try to retain more of the business, but the reinsurer wanted to maintain at least a 50% relationship. As time went on, and our programs became more structured, we were able to provide our reinsurers with specific criteria on the types of cases that we would be writing either on a guaranteed issue or simplified issue basis. After we had an agreement on the structures and had approval from the reinsurer, we began to place all our cases on an automatic basis - 50% quota share within our retention, and up to twice our retention in excess coverage.

MR. LEVY: Usually a program like this one does not accumulate enough experience for at least 5 years, so it takes quite a while before a reinsurer is comfortable going to an excess basis. Where a program is experimental, a quota share relationship does make the most sense.

MR. VANDERSCOFF: It is very dangerous for the reinsurer to take reinsurance on a guaranteed issue basis using excess coverage only. It would not be fair for the ceding company to push for that.

MR. JOHN O. MONTGOMERY: How do you handle the premium tax on direct mail, mass marketed,franchise and group cases? We know of a few states that are getting these group trusts, and thereby are avoiding paying premium taxes in other states. Two states in particular doing this are Missouri and Rhode Island.

MR. WHIMPEY: For all of our group business, we keep records of state of residence of the employees and dependents, and pay premium tax based on those state allocation records, regardless of whether or not the policy is issued through a trust.

MR. MONTGOMERY: There is much concern in the NAIC about these trusts that are set up out of Missouri and Rhode Island which avoid payment of premium tax in the other states in which they operate. I believe there will be some reaction to this in the future by the NAIC.

MR. SIBIGTROTH: What guidelines might the NAIC set for the payment of premium taxes?

MR. MONTGOMERY: I believe they will be along the lines of what Mr. Whimpey has stated.

MR. JOSEPH W. MORAN: The model group life insurance bill that was endorsed by the NAIC proposes the elimination of the traditional statutory mandates for minimum participation requirements, definition of groups, to whom group life policies can be issued, and so on. I presume that all companies are supporting the adoption of this bill in the various states, and I would like the panel's comments on this issue.

MR. WHIMPEY: I have two comments. First, most of what I have said before regarding the current situation does not rely on this model bill, but some of the future events will. Second, we support the bill. We have some comments on it, but that will not affect our basic support.

MR. LARRY WARREN: Traditionally, individual product pricing has been done using asset share techniques, while for group products, loss ratio techniques have been used. As group and individual life and their associated operations gradually converge, will pricing techniques also converge?

MR. SIBIGTROTH: The interesting feature we have seen in group insurance, particularly in the area of small group guaranteed issue, is that we do experience elevated claim levels in the first two policy years, with the loss ratio being around 75% of premium. Beyond that point, the loss ratio tends to drop off significantly to around 50 to 60% of premium. The persistency on our group business has been very good. We have had a renewal lapse ratio of about 7%, so the profit track for this type of business is an initial investment during the first two policy years, but satisfactory profit margins thereafter. However, our experience is probably not similar to that of large group writers. This is also not viewed favorably from a reinsurance point of view if we try to recapture coverage when profits emerge.

On the individual side, one must take much more care in constructing a guaranteed issue program because of the high acquisition costs, and the high incidence of lapse, particularly if you have seen a few significant claims. Mortality tends to increase as you move into the under 10 life area if guaranteed issue is offered at that level. In short, pricing considerations remain somewhat different for group and individual sales.

MR. WHIMPEY: Two notes: for our small group portfolio, we establish stable age and sex specific rates, and no groups are rated on their own experience. We do use the equivalent of an asset share technique in projecting the small group fund that develops through a combination of claims experience, administrative experience, and persistency experience. To that extent, there is a similarity. With respect to larger groups, where permanent insurance is involved, our pricing techniques are essentially the same, actuarially, as for individual permanent insurance products that do involve asset share testing.

MR. LEVY: As the products merge, and we see groups paying higher first year commissions, there will be a need for merged pricing techniques.

MR. DICKSON J. CRAWFORD: Mr. Whimpey, you began a very interesting commentary on some of the administrative aspects of your very small groups, and I wonder if you would continue it. I would like to get a feel for the everyday administrative aspects. How do you keep administrative costs down on these groups?

MR. WHIMPEY: Our small group portfolio is highly computerized. The proposal administration system works out of the central computer facility, with terminals in agency offices across the country allowing direct input and overnight production of these proposals in agency offices. The issue function is sufficiently limited so that complete definition of the universe is possible. The premium billing and administration is similarly computerized and is in a central location. Bills go out monthly, and there is an opportunity, on a monthly basis, for employers to report changes.

MR. JACK MASTERMAN: I have two questions for Mr. Levy. You stated that the standard class is blossoming, while at the same time in the individual area, the standard class is being broken into subclasses - smokers vs. non-smokers, and so forth. Do you see this as a trend that may move into the group area? The second question is on the value of inspection reports. It is something our company dealt with a few years ago, so in these last few years we have obtained fewer than six inspection reports to underwrite about 150,000 individual policies. In that period, we have had no significant deterioration in our mortality experience. Will this also be a trend?

MR. LEVY: With regard to inspection reports, your company practice represents the industry trend. In many states, companies have shifted to telephone inspections. This is an interesting development because in addition to finding out information of an inspection nature, they can also fill in the application, and develop a rapport with the applicant. The insurance company is no longer cold and impersonal.

To answer your other question, non-smoker classes have already started on the group side. I have noticed ads from Phoenix Mutual in trade publications advertising non-smoker discounts for small groups, and I know of a small company in Pennsylvania that has an active group program with a pricing structure that distinguishes between smokers and non-smokers.

MR. SIBIGTROTH: Are you finding that reinsurers are using separate rates for smoking and non-smoking group reinsurance as they are, in many cases, for individual reinsurance?

MR. LEVY: No. We have not reached that point yet, since there are not enough companies differentiating their group rates, but I am sure that this will be considered when it does happen.

MR. MICHAEL G. WARREN: I have a few comments on the Canadian scene. First of all, as Mr. Montgomery reminded us, however blurred our lines may be, we still must pay our taxes. In Canada, more and more money has been piling into Registered Retirement Savings Plans in the last 5 to 10 years, and this tends to remove the market for individual agents selling cash value life insurance. Therefore, the individual business is being driven more and more toward term insurance. At the same time, there is a $1,000 interest allowance for individuals who have investment income. These allowances are free of tax but are not available on interest income being built up within an insurance policy. There were some tax revisions in 1975-76 affecting insurance companies. The intention of the revisions is that insurance companies should pay more tax, particularly on business that carries reserves. Finally, the concept of flow through to the policyholder was more or less abandoned. The result of all these factors is that individual business becomes more expensive to price and more expensive to sell.

There are two other things I see in Canada as driving business away from individual agents. The first is inflation. We have experienced very high rates of inflation, and people expect that to continue. Salary related group insurance plans provide a defined multiple of salary. The perception of the individual buyer is that non-par life insurance is becoming more and more useless, and even par life insurance is not adequate. This represents an opportunity for individual actuaries to come up with some innovative mechanisms for some sort of terminal dividend. Experience in the United Kingdom on this subject should be studied.

The second is the activities of the major chartered banks. We have 5 or 6 major chartered banks which operate across the country, and they are offering insurance on consumer loans, and insurance is being considered on business loans (an enormous source of individual business) and on mortgage loans. All of these activities represent a very large move by these banks into the insurance field. They are not actually licensed to sell insurance, but they are, in effect, using their financial muscle to provide insurance to their borrowers of all types. Also, at the beginning of the year, the Bank of Montreal offered insurance to its depositors. Here there is a less obvious insurance need but is, nonetheless, a sales tool, because it is being offered without any reduction in the interest rate on deposits. This latest trend is the most important one which seems to be driving business away from the individual agent, thereby reducing his income.

MR. SIBIGTROTH: Thank you very much Mr. Warren for your comments on the Canadian scene. If we have no reaction from the panel, I would like to request their comments as to the use of term vs. permanent within the group and simplified issue marketplace.

MR. VANDERSCOFF: Because term rates are still fairly low, the long term income of both the agent and the company is declining. We encourage the use of permanent insurance, especially on the principals for two reasons: First, it is income to the agent and to the company, and the second is so we can offset some of the extra mortality which occurs at the top class of each case. If we can get permanent insurance, the likelihood of the individual being highly substandard or uninsurable decreases somewhat, because if they are highly substandard or uninsurable, they would want to get the highest amount of coverage for the lowest possible cost. Permanent insurance represents 10 to 15% of our total volume on all of our cases.

MR. MORAN: In enumerating some of the traditional distinctions between group and individual life insurance, one was not mentioned - the practice of permitting re-rating of existing coverage under group policies. Under individual policies, it has been traditional to guarantee the entire scale of future renewal premium rates. I would like to have the panel's comments on the possible blurring of this distinction in either direction, that is, either the removal of future renewal premium rate guarantees on individual policies, or the inclusion of guarantees of future renewal premium rates on existing coverage under group policies.

MR. LEVY: On the individual side, over the last several years we have seen the emergence of the non-guaranteed premium contract. This is analogous to early group contracts where the contracts were cancellable and premiums were not guaranteed. We tend to think of cancellable contracts and non-guaranteed premiums as the opportunity to keep our products current, so that if future conditions require a reduction in premiums, that can easily be accomplished. It can also work the other way - premiums can be increased. This kind of product will be much more heavily used in the future.

MR. VANDERSCOFF: Three years ago, when we entered this marketplace, we used the non-guaranteed premium structure. We also used it for regularly underwritten business. It was not very successful with either one. Because we received very limited sales, we abandoned this idea and guaranteed the premiums. One day, with the evolution of the non-guaranteed premium structure, it will return, especially in the guaranteed issue area.

MR. WHIMPEY: On the group side, for medium and large size cases, currently it is not uncommon to guarantee premium rates for two, up to as many as five years, but this happens only after examining the merits of each individual case, not as a general rule. For small groups, there is no pressure or any need to move to guaranteed rates, particularly since in the small group, most of the expense comes from the health insurance side, which receives most of the attention.

MR. GERALD S. PARKER:* In the area of guaranteed premiums, there are some interesting parallels in individual health insurance. For many years, the idea of a guaranteed premium and a guaranteed benefit was considered essential.

When we brought out a social insurance substitute coverage in our disability policies, the reaction of our agents was, "It cannot be any good because nobody else has it." You will see in the future, the pricing, the coverages, and the relationship of the coverage to who has it, all must be adjustable, and agents will have a great deal of trouble swallowing this. Eventually, the smart ones will see that it works. The same thing will happen in the blurring of group life and individual life. It would not be surprising to see the changes in all these lines going in parallel.

*Mr. Parker, not a member of the Society, is a Vice-President of the Guardian Life Insurance Company.