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LIFE INSURANCE PRODUCT DEVELOPMENT: A MARKETING PERSPECTIVE

Moderator: JOHN H. FLITTIE. Panelists: JOHN A. JOHNSON, L. JAMES L. RIVERS, JOHN H. STIGAARD***

1) Effect of Economic Recovery Tax Act of 1981 on Estate Tax
   a) Provisions
   b) Impact on Estate Planning
   c) Product Design Implications
   d) Conservation of Present Business
   e) Marketing Implications

2) Effect of ERTA on Gift Tax
   a) Provisions
   b) Insurance Implications
   c) Use of Non-Qualified Single Premium Deferred Annuities as Gifts

3) Effect of ERTA on IRA and Keogh Plans
   a) Provisions
   b) Product Design Implications
      (1) Individual
      (2) Group
   c) Marketing Implications

4) Retired Life Reserves

5) What type of sales presentations and marketing methods are used to illustrate the operation and tax effect of these products?

MR. JOHN H. FLITTIE: When the program was established for printing in the meeting schedule, we did not know that we were going to have a major new tax law by the time of this program. The impact of this tax law is so great on the life insurance industry that we have chosen to restructure the program slightly, to focus on how specific aspects of the 1981 Economic Recovery Tax Act, or ERTA, as it's now known, apply to various aspects of life insurance company marketing operations and product development. We will look at this provision by provision, and will start with the use of life insurance in estate planning. The new tax act, with major changes in how estate are taxed, perhaps changes the need for life insurance, and has attracted a lot of attention in the popular press. For example, a July article in The Wall Street Journal quoted Leonard Wolf, who owns a small company in New Jersey and who bought a big policy to pay estate taxes.

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When he was asked if he planned to drop his life insurance, and invest the money instead in the business, Mr. Wolf replied, "We'd be stupid not to."

Contrasted to that is a recent article from The National Underwriter, quoting Dick Littie, a marketing Vice President at Connecticut General, as saying that the new bill will have little or no adverse effects on insurance sales, and may have possible long-term benefits. He also said that the accumulation aspect of the law is very beneficial to the insurance industry. Another article from The National Underwriter quoted a very successful agent from Philadelphia Life as saying that the new tax law is not a disaster, but rather "the CLU Relief Act of 1981".

With these different viewpoints in mind, let us look first of all at the estate tax aspects of ERTA. Jim Rivers will lead our discussion.

MR. L. JAMES L. RIVERS: The one thing that is just as certain as death and taxes is that most people do their best to avoid both. Our industry has been accused of profiting from both. We force people to reflect upon their inevitable end, and in so doing we get labeled as the cause of it all. Such is the fate of anyone who would be the willing bearer of bad news.

The recent change in the estate tax law illustrates the point very well. In June of this year, before the act was passed, an article appeared in Forbes magazine advocating the adoption of the act. The author made his case by stating that if the founder of a small business cannot afford the premiums for the necessary amount of life insurance on his life to pay the estate tax, "...His heirs will not be able to keep the business firm when he dies." The author then characterized the necessary premiums as a "crushing" burden on the business and quoted one business owner as saying, "sometimes I think I am really working for the insurance company."

In short, the author characterized the insurance company as the cluprit--not Uncle Sam; and, the cost of the tax was the insurance premium, not the ultimate tax bill.

What all this goes to prove is that success can breed failure. Our industry has been so successful in exploiting the estate tax as a reason to buy life insurance that the public has come to believe in the life insurance agent's estate planning creed. That is, estate planning is the orderly conversion of a man's assets into life insurance premiums.

Did the recent estate tax reform undo it all? Must we now anticipate not only drop in sales, but an increase in lapses by people shedding the burden of premiums previously incurred to pay estate taxes?

I think not, since very few had enough insurance to begin with. In the case of the typical small business, the buy-sell agreement is now underfunded due to inflation.

Also, more insurance is needed on the owner manager to provide the surviving managers with a financial cushion to see them through the loss of the decedent's managerial skills, his personal efforts and his personal business contacts.

Finally, very few people own enough life insurance to adequately replace

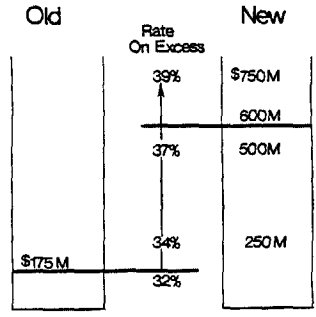
their income for the benefit of their dependents. We here in this room believe in life insurance, but how many of us with dependent families have insurance equal to five times our current income? In short, whatever existing insurance is no longer needed to pay estate taxes is probably needed to fill another neglected need.

Aside from this, the kindness extended by President Reagan to the coddled and uptrodden in our society may be overrated. He has not put an end to death taxes, nor to the need for estate planning (quite the contrary). First, the death taxes imposed by the various states must be considered. They are likely to go up in the future, mopping up the reduction left behind by the Federal Government.

Second, we must consider the impact of inflation.

Year of Death	New Credit	Estate Passing Tax-Free
'81	$47,000	$175,625
'82	62,800	225,000
'83	79,300	275,000
'84	96,300	325,000
'85	121,800	400,000
'86	155,800	500,000
'87	192,800	600,000

Here are the increases in the tax credit over the next six years. When they are translated into the size of an otherwise taxable estate that can pass tax-free, we see that by 1987 as much as $600,000 will pass tax-free. But, what if inflation averages 10% in the future? Today, a taxable estate of $275,000 pays taxes on the difference between $275,000 and $175,000 or $100,000. If the estate grows at a rate of 10% it will be worth about $700,000 in 10 years. At that time $600,000 can pass tax free. That will make the top $100,000 subject to tax; and, what is worse is the fact that the tax will be higher on this $100,000 than on the $100,000 taxable today. Why? Because the rate will be higher.



Today that portion of the estate first subject to tax, after subtracting the $175,000 which passes tax free, is taxed at the rate of 32%, and then at 34% for the excess over $250,000, and so on up the tax scale.

After 1986, the rate first applied after subtracting the $600,000 passing tax-free will be 37% and then 39% on the excess over $750,000, on up the scale. In short, once the taxable estate exceeds $600,000, it will find itself in the big leagues; and, if inflation does not subside, the big leagues will be expanding continuously.

This new credit is chicken feed, however, compared to the reduction in tax made possible by the new marital deduction which becomes effective in January of 1982. Apparently, Nancy Reagan convinced Ronnie that tax considerations should not be an impediment to his generosity. She felt that anything he leaves her should pass tax-free, regardless of the amount.

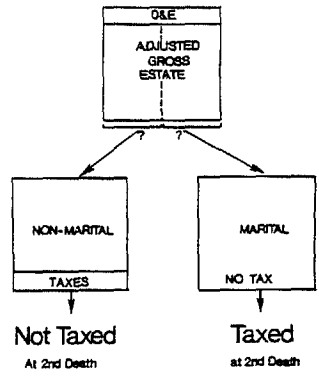
New
Marital
Deduction
as of 1/1/82

1. No Limit

2. Life Estate Only Qualifies

So, the present 50% limit on the marital deduction has been removed. Beginning next year, everything left to a surviving spouse will be deductible, whether it be $1,000 or $100 million.

Ronnie wasn't all heart, however. He also changed the law so that he can have a marital deduction even if he leaves his estate to Nancy in a trust giving her the income only and keeping the principal intact for eventual distribution to a person of his choice, rather than to a person of her choice. This new kind of marital deduction trust is being referred to as a Q-TIP trust. (That stands for a qualified terminable interest.) It is an interest in property which terminates at death and automatically passes to another. Finally, though Ronnie won't have to pay taxes on anything he leaves to Nancy, she will have to pay taxes when she later dies. In order to see how this works, let's see how the typical estate was planned under the old law which will be with us until New Year's Eve.



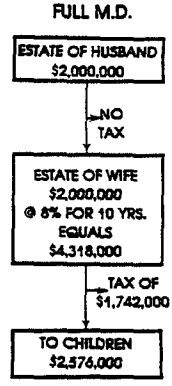
This is the estate of a man with a surviving wife and children. After subtracting the debts and administrative expenses of his estate, the current law allows as much as 1/2 the remainder to pass to the wife tax-free. But this same amount is taxed at the subsequent death of the wife. In other words, this 1/2 is taxed once, at the second death.

The other half is taxed at the prior death of the husband, but if it is left in a non-marital trust for the benefit of the wife, it will not be taxed at her death. In other words, this part is also taxed only once, but at a different time.

In summary, the entire estate is taxed once--1/2 at the husband's death and 1/2 at the wife's death; and, the split lowers the tax rate applied to each half since two estates are involved.

The new marital deduction available January 1, 1982, is unlimited. All of the estate can be left to the wife tax-free. This is the reason so many commentators are suggesting that there is no need to buy life insurance any more to pay estate taxes. What this overlooks is the fact that the tax is not eliminated--it is merely postponed. The day of reckoning comes when the wife subsequently dies. Unless the wife remarries, she will have no marital deduction when she dies. Even if she does marry again, she may be without a marital deduction. Her first husband may leave her a life estate only by putting his entire estate in a Q-TIP trust. He may do so to keep his hard-earned assets out of the hands of a second husband, possibly an amorous beach boy, or the children of a second marriage. Furthermore, the full estate will be taxed at her death at a higher rate than if the estate has been split into two parts. Finally, we must consider the impact of inflation. Even if the wife and children consume all the income, inflation is likely to increase the value of the assets.

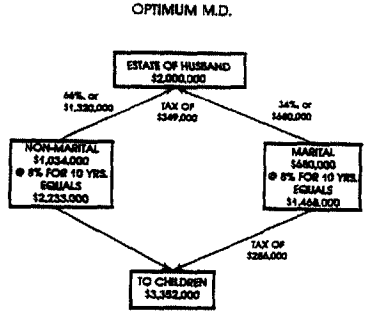
There may be wisdom in paying some tax at the first death to avoid paying too high a tax at the second death. Assume we have a husband who holds all the family assets, totaling $2,000,000. The wife has no assets of her own.



Let's also assume the husband dies first and takes full advantage of the marital deduction by leaving everything to the wife either outright or in a Q-TIP trust.

There will be no tax at the husband's death, so the wife will get the full $2,000,000, at the time of his death. Now, if the wife lives for ten more years and if inflation causes the assets to increase in value at the average rate of 8%, that $2,000,000 will grow to $4,318,000 by the time the wife dies. The resulting tax will be $1,742,000 leaving the children with $2,576,000.

Now let's assume we do something else. Let's assume we set out to pass the largest possible amount to the children by splitting the husband's estate and, let's use a computer to tell us what the marital deduction should be assuming the wife survives for ten years, and that the assets increase in value at the a rate of 8%.



The computer tells us that the husband should qualify only 34% of his estate for the marital deduction, or $680,000. The balance should go to a non-marital trust which will not be taxed at the wife's death. The result will be some tax due at the husband's death--$286,000--but the ultimate result for the children will be substantially improved.

First, the $680,000 which qualifies for the marital deducton will grow to $1,468,000 by the time the wife dies. Meanwhile, in the non-marital trust, the balance left after the estate tax paid at the husband's death will grow to $2,233,000.

At the wife's death only the marital share is taxed. The tax is $349,000. The $1,119,000 left over, plus the $2,233,000 from the non-marital share leaves the children with $3,352,000. How does this compare with the result of using the full marital deduction?

TAX SAVINGS FROM SPLIT

WITH OPTIMUM M.D.	$3,352,000
WITH FULL M.D.	2,576,000
EXTRA FOR CHILDREN	776,000

The result is $776,000 more for the children. Even if we discount this savings back to the husband's death, at 8%, the resulting savings is about $360,000. In summary, if one recognizes inflation, it doesn't pay to postpone all the tax until the second death. Furthermore, this isn't the only tax advantage of a split estate. Our moderator, John Flittie, pointed out another, involving income tax.

If the entire estate qualifies for the marital deduction, all the income from the estate is taxed to the surviving spouse. Assuming in our example that the estate throws off 5%, the wife's annual income will start at about $150,000 and increase thereafter. That will put her top $50,000 of increase in the 50% bracket.

If, on the other hand, the estate is split, the trustee of the non-marital trust can pay some of the income to the children of use it for their support rather than pay it to the wife. If he does so, that much of the income will be taxed to the children in their low brackets. For example, if there are two children who have other income of no more than their personal exemptions, $25,000 can be distributed to each of them, with a resulting income tax savings of $16,000 a year.

In short, there are several reasons why one should use restraint in manifesting love and affection for a spouse. Sometimes everyone is better off by splitting the estate.

This being the case, what kind of life insurance policy is needed by the estate planner of the future? Some are suggesting joint life. They say you should leave everything to the surviving spouse and purchase joint life equal to the larger tax payable at the death of the surviving spouse.

This solution has a virtue of simplicity, but it ignores the apparent wisdom of paying some tax at the first death. If also places a heavy emphasis upon the determination of the life expectancy of the spouses and the inflation rate as of the date when the insurance is purchased; a better solution may be to postpone the determination of the survivor's life expectancy, and the likely inflation rate, until the first spouse dies. This can be done under the new law.

For example, our husband with the $2,000,000 estate might place the bulk of his estate in a Q-TIP trust and give his executor the power to determine how much of the estate is to qualify for the marital deduction. This makes post-mortem estate planning possible. Immediately after the death of the first to die, the executor can consider: (I) the age and health of the surviving spouse, (II) the degree of dependency of the spouse and children, and (III) the economic outlook. With this update on the environment, the executor is far more likely to select the right amount of marital deduction. Unfortunately, all this demands life insurance coverage of a very different type than we have today. If an estate planner were to be asked what he wanted, this is what he might say:

1. A policy that will pay death proceeds at the death of either spouse, or at the death of both spouses.

2. A policy which will pay only enough at the first death to pay the federal and state taxes due at that time. Keep in mind that

the amount due will be the product of several variables--the value of the estate assets, which spouse dies first, and in some cases the amount of marital deduction elected by the executor.

3. To the extent that death proceeds are not received at the first death, the proceeds payable at the second death must be sufficient to match the higher tax bill due at the second death. Keep in mind that the amount due at the second death will depend on the rate of growth and length of time between the first and second death.

4. And, if this isn't enough of a challenge for you, consider some of the riders which may be needed. For example, consider a rider which waives future premiums at the death or disability of just one of the two insureds designated by the applicant, such as the breadwinner; or consider the right to exchange the joint life coverage for individual coverage on the life of one or each of the two insureds. This is needed in the event of divorce.

Even if we develop such a product, how many agents will be able to explain it to a buyer?

If anyone has some suggestions, I am anxious to hear them.

MR. FLITTIE: Thank you very much for that clear and informative discussion of estate planning, Jim. I think this demonstrates the need for computer models and software that test the total tax alternatives. Not only is estate tax affected, but so are income tax, gift tax, and other taxes. At this time I'd like to ask John Stigaard to give further reaction to the estate tax aspects, particularly from the viewpoint of the agents that he has recently been working with.

MR. JOHN H. STIGAARD: The meeting attended yesterday was sponsored by Farnsworth Publishing. In a session the night before the meeting, concerns about the future were being reviewed. For example, the agents now see a changed market with the new tax act. They're not comfortable with a lot of this change. Most of the people attending the session planned to acquire the new Financial Services Designation of the American College. They may be moving more in the direction of total financial planning. The agents also recognize that they will need to work harder for the estate tax sale than they did previously. It will not be an "open and shut" development of a need, as Jim so ably pointed out.

We have to analyze additional factors, and some of the service groups are programming very significant changes in the estate analysis area. There will be an increase in the number of choices a client must make. Attorneys will do extremely well in the next few months, due to the number of wills that will need re-writing.

The agents identify that a good deal of future sales will result from the need to defer taxation. Current estate tax problems may generate the sale, but in closing situations income-deferral plans may be discussed (e.g. non-qualified salary contribution, deferred compensation, etc.). Tax leverage will be used in the sale to get both living and death benefits to the clientele.

The agents wanted me to bring you a message. Their biggest concern is the reduction of commissions. Of course, that leads us into Universal Life. Many of the agents are either going to "fee-for-service", or are already doing this. Some of them are making more money from "fee-for-service" than they are on first-year commissions.

Many agents recognize a need for hardware and software computer systems in their own offices. They are looking for assistance in getting that equipment and the programs they need. They hope that there will be adequate compensation in the pricing of the products, but they are not taking any chances, because they are looking at other markets, so that they will be in more lines of business (e.g. financial planning and tax shelters). There is a good deal of concern over whether we will be coming through with the money for them.

MR. FLITTIE: Thank you, John. Next to respond from the home office product development standpoint is John Johnson.

MR. JOHN A. JOHNSON: Although I won't come up with any solutions to the problems Jim outlined, I hope that some product development which matches the needs in the estate planning market (because of the change in the tax law) will result. First of all, I would like to give you some background. My view on the impact on life insurance will be from the perspective of a company whose main estate-planning thrust is in the farm and agri-business market. It might be different from the more sophisticated markets in which Mr. Stigaard deals.

I would like to mention some of the products which we currently sell in the estate-planning area. Typically they are traditional non-par permanent life insurance on a single-life basis. Originally these products were on a guaranteed-cost basis, but we have now gone to an indeterminate premium form. These products are sold because the estate tax need is permanent, and the lower level of non-par premiums at the older ages can compete favorably with par policies, especially on a going-in cost basis.

We also have a joint life policy, with the death benefit payable on the first death were which was developed for use in the estate planning market. These policies typically provide the survivor with the right to purchase a new single life policy without evidence of insurability for a face amount not to exceed the original joint whole life benefit. My company issues such a contract with a little wrinkle. To recognize the increased taxes payable on the second death because of the loss of the marital deduction, a rider provides that the survivor may purchase a life insurance policy for an amount up to twice the face amount of the joint life policy.

As was mentioned earlier, with the new tax law and the unlimited marital deduction, joint life policies payable on the second death are getting plenty of publicity. Lawyers, accountants and other professional advisors working in this market seem to be touting these types of policies. Even without the change in the tax law, second-to-die policies fit the need in the estate planning market because of the larger tax payable on the second death because of the loss of the marital deduction. These products provide large amounts of insurance at a fairly modest cost compared to traditional whole life policies. Joint life policies payable on the second death are currently offered by a few companies. The 1981 Who Writes What listed

about 15 companies having such a product. My company does not currently issue such a policy but is considering developing one.

However, I think life companies have been somewhat reluctant to offer second-to-die policies for several reasons.

a. Compensation to the agent is usually quite low because the premium, if payable until the second death, is quite small. The agent would rather insure both lives and get two commissions than make the one sale with a modest commission. This is a market in which a considerable amount of development work on the part of the agent is required and he needs to get compensation commensurate with the effort expended.

b. From a psychological standpoint the second-to-die concept is a tough sale to make because the second death seems so distant. Individuals seem to be able to relate to their own or their spouse's death but not to both. In addition, it seems in some cases that the small business owner is interested in providing for the surviving spouse, but not beyond that. In many cases, his children have careers of their own and are not interested in the family business. An exception to this is the family farm where there seems to be a great deal of interest in keeping the farm in the family.

c. The product is a little more difficult to develop than a standard whole life policy. The actuarial formulas for cash values and reserves provide a good test for the life contingencies student. For those interested, the March 1978 issue of The Actuary contains formulas for two methods of calculating cash values and reserves on these types of policies. At first glance they appear to be quite formidable.

d. Because of the complexity of the product and market, good training of agents and sales materials are required. Obviously, sufficient sales volumes must be generated to offset the increased development and training costs associated with a product designed for very specific markets.

While the second to die joint life policy in a traditional form would seem to fit the needs of the exactly, several other new products involving the second-to-die concept could possibly be developed for this market:

a. A traditional Adjustable Life policy (of the Minnesota Mutual and Banker's Life variety) is currently offered by my company on a single life basis. An Adjustable Life policy which insures two lives and would pay proceeds only upon the second death is possible. The policy could have premiums payable until the second death. The flexibility of the Adjustable Life would help greatly in the estate planning market. Cost of living increases associated with Adjustable Life policies would help provide the extra coverage needed due to the inflation-caused increased estate taxes. The flexibility in premium payments associated with Adjustable Life would also help, especially in businesses like farming with erratic cash flow.

On the negative side, the combined complexities of Adjustable Life and second-to-die coverage would probably be too much for agents, clients, and actuaries to comprehend.

A second idea which probably has more merit would be to combine the second-to-die joint life concept with Universal Life.

A Universal Life policy which paid a specified amount on the first death (of two insureds) and another amount (typically higher) on the second death would seem to be feasible. The amount paid on the first death could be used for various needs, such as a benefit to provide liquidity or to pay future premiums on the remaining insurance. Here again the flexibility in death benefits and premium payments which are features of Universal Life would be helpful in this market.

The lower-than-whole-life-type commissions generally associated with Universal Life policies could present difficulties with such a product from the agent's standpoint. However, a large first year per policy commission and load could be used to compensate the agent for his work. The agent can justify to the client the large per policy commission because of the amount of effort expended on the sale.

In summary, it would appear at first glance that the changes in the estate tax law could have a rather negative impact on life insurance sales in this market. In many cases, this may be true. However, there are situations in which one can see some positives and actual increased sales resulting from the changes. Also, some unique products may be developed to serve the changing needs of this market which have resulted from the new tax law.

MR. FLITTIE: Before we open this to discussion from the floor, I'd like to ask our two CLU's a question. Another reason that has been given for no need for life insurance in estate planning is the "stretch out" provision for payment of all or a portion of the estate tax. Is there a case for showing that life insurance funding is cheaper than utilizing the "stretch out"?

MR. RIVERS: I've always liked the "stretch-out" with life insurance, because of the first $300,000 of tax that could be postponed under the new law, at 4%. I'd love to have that fully insured, receive the death proceeds, invest it until the due date, and only pay 4% on it. I can leverage my death proceeds. Meanwhile, I don't have to worry if I'm ever going to be able to come up with that money. I'm holding the proceeds in a fairly liquid form, eventually to meet the estate tax.

MR. ROBERT COMEAU: I wish to direct a question to Jim. I found your examples quite interesting, except that you did not take into consideration one important factor. That is the asset deterioration of the estate, since the spouse needs something to live on. The $2,000,000 estate would not have a tendency to increase with inflation, but would more than likely deteriorate because of the spending characteristics of the spouse.

MR. RIVERS: You may criticize my assumptions, since I was trying only to get the basic point across. Your point is well taken. If we were throwing off 5% on the average, across the board, the spouse would have $150,000 to support herself and her family. Possibly that would increase with increasing inflation yields. I'm assuming in the illustration that she is not consuming any principal. Perhaps that is not accurate, because in many estate plans, the estate is split and one-half contains the part not taxed in the spouse's estate, including all items expected to grow in

value. The other half, which qualifies for marital deduction and will be taxed in her estate, contains assets which are relatively liquid and can be consumed readily by the spouse. I didn't include these factors in the equation due to time limitations. Therefore, I concede your point.

MR. FLITTIE: We will now move on to another major section of the new tax act, the IRA's. The 1981 Tax Act extended, very markedly, the number of people eligible to purchase an IRA, and also extended the limits under Keogh plans. John Johnson will lead this off with how he sees it from a life company standpoint.

MR. JOHNSON: First I'd like to make a few brief remarks about the size of the IRA market. The eligibility changes John referred to essentially have doubled the IRA market.

It has been roughly estimated that 115 million employed Americans plus 20 million spouses will be eligible for coverage under IRA's in 1982.

In addition to an expansion in numbers, the new prospects for IRA's should be a better market than those currently eligible for IRA's since they already have a pension plan and are conditioned for retirement planning. Typically, they should be more concerned about the impact of inflation on current pensions and the potential changes in Social Security retirement benefits which are currently being discussed. These people would seem to have an economic incentive to set up a pension plan of their own.

The combination of the lower individual tax rates and the deductions allowed for the IRA contributions combine to make it financially attractive to contribute to an IRA.

Thus, there is a huge market for IRA's and many will be able to afford to make the contributions. The big question is how do you penetrate this market.

I will answer this question from the perspective of one who is associated with the individual life insurance and annuity operations of a company. While there will likely be some IRA sales success on an individual basis, I think the greatest penetration will be achieved on a group marketing basis through existing employer/plan sponsors using deductible voluntary contributions to existing plans or as a separate employer sponsored savings program. However, we see several ways for individual agents to penetrate this market.

a. Existing annuitants who currently have IRA annuities can be solicited for an increased contribution to reflect the increase in the maximum annual contribution from $1,500 to $2,000. Since this results in little additional commission dollars to the agent, he must do this as quickly as possible - either by telephone or mail. In any case, this should be an easy sale and the agent has easy access to these prospects.

b. Agents can contact their current life insurance policyholders. Those policyholders who are most likely to make IRA contributions would be contacted first. The characteristics of a likely buyer would be between the ages of 35 and 60 and those with moderate to large sized life insurance policies. Again, because of the rather modest

commission associated with deferred annuities, a simple sales approach is needed.

c. Some individual agents have sold payroll deduction life insurance or small group medical expense policies to small employers (less than 100 employees, usually considerably less). In these cases, individual annuities can be marketed as a separate employee benefit plan not tied to a pension or profit sharing plan. This is a simple approach which only requires the employer to make payroll deduction of the IRA contributions available to his employees.

The individual annuity approach with payroll deduction has the practical advantage of simplicity over having employee contributions made to the employer's retirement plan. If an employer's retirement plan permits voluntary contributions, the plan must make certain reports to plan participants and the IRS. This paperwork and other potential administrative problems may be more than the employer bargained for. In any event, few companies are likely to have the facility of voluntary contributions to the retirement plan available on January 1, 1982.

If the agent is able to get employer sponsorship of the IRA, he will be in a great position to generate larger amounts of contributions to IRA's and larger amounts of commissions. This may be one of the few ways that the IRA market is worth the individual agent's time.

Many accumulation vehicles are eligible instruments to deposit contributions for IRA's. In this market insurance companies face competition from savings and loans and mutual funds.

The products which a life company offers in the new IRA market will not be too different from those currently being used, i.e., either individual or group annuities on either a fixed dollar or variable basis, with increasing emphasis on variable annuities.

For the individual and small group markets, individual flexible premium deferred annuities (fixed and variable) can be used. A typical fixed dollar annuity contains no front-end loads but has back-end surrender charges which may run off over a number of years. Competitive rates of interest in the 13%-15% range are currently being credited with an interest guarantee of 4% or 4.5%. To avoid investment antiselection, some deferred annuities have a surrender charge which is eliminated only if the individual annuitizes. Other contracts may feature a market value adjustment for early termination. First year commissions (plus overrides) in the 3% to 6% range are typically paid.

Variable annuities appeal to an increasingly larger segment of the population who want more control over the types of investments their annuity dollars are going into. This product also features no front-end and has back-end surrender charges (to get back unamortized expenses for early terminations) which run off over a number of years. The monies are invested (at the direction of the participant) in one or more funds in a Separate Account of the company. Funds are typically invested in money markets, equities or fixed income securities. The accumulation value of the variable annuity varies directly with the performance of the various funds. Variable annuities have the real advantage to the life company in that the investment risk is passed on to the policyholder. Although this

also reduces the potential for profit, the investment risk is one which I will gladly give to the annuitant.

A large part of the competition for IRA funds will come from savings and loans and other financial institutions other than life companies. (Of current IRA deposits only about 20% are in life insurance companies.) In competing with these other financial institutions, life companies can emphasize their strengths - the service provided by an agent, life settlement options, financial stability (as opposed to a savings and loan), and a national image (as opposed to the more regional image of a bank). However, I do think that competition which will come from both inside the outside the insurance industry will keep commissions low, interest rates high, and profit margins thin on IRA products.

It would seem that life companies have reasonably competitive products for the IRA market and that with aggressive marketing could capture a larger segment of the IRA market.

MR. FLITTIE: John Stigaard, do you have any further comments on IRA's?

MR. STIGAARD: I think the group approach will work with a larger employer. However, there is a very significant number of small businesses with one, two, or three employees. Also, due to ERISA problems involved in setting up these plans, many employers may be unwilling to establish another employee benefit program. The individual market does exist. Salesmen, by selling, may pick up a lot of the business which the savings and loans were hoping to acquire. I think there is a ready market on the individual basis, but the issue is whether the agents can afford to sell it, and still have a competitive product.

MR. FLITTIE: One of the other major facets of the new tax act is the dramatic expansion in the amount that can be gifted, from $3,000 per year to $10,000 per year (or $20,000 jointly with spouse). Does this create any opportunities for creative life insurance sales?

MR. STIGAARD: I think it certainly helps Retired Lives Reserve (RLR) considering that some authorities have identified a gift tax problem at retirement, (regarding present value of future benefit) However, the RLR is now assigned to the spouse, since there is an unlimited gift to the spouse. Therefore, no tax is due at retirement. The change in the law has solved problems in this area.

Also, the raising of gift tax limits now allows a grandparent to pay full school tuition (to a non-dependent) without it being a taxable gift.

MR. FLITTIE: Leaving the tax act and looking at other recently-developed tax-related products brings us to Retired Lives Reserves. John Johnson, will you please lead us off on the current state of the art on Retired Lives Reserves?

MR. JOHNSON: I will describe the RLR product which my company is currently offerring.

We offer a high first year load deposit administration-type contract on an individual basis. Monies are invested in the general account of the company and interest credited on a New Money basis. A current rate of

interest is credited on the fund. Guaranteed interest rates are more modest and are graded down by contract year. Both a current and guaranteed set of retirement purchase rates are contained in the contract.

Two basic products are available with the only difference being the commissions and loadings. Our original RLR product was high first-year commission (50% basic writing agent's first-year commission plus overrides) with a high first-year load (100% first-year load for the longer funding periods).

Some time after the introduction of this product, a product with more moderate commissions and loadings (approximately 50% of the other product) was designed. It was thought that there would be a moderation in the commissions and loads as more companies entered the RLR market. However, the sales on the moderate commission product have been minimal, being sold only in a few fairly large cases, those of 100 lives or more. Apparently, our sales people see the RLR as a replacement for whole life insurance and want to sell a product which gives them whole life type commissions.

The RLR product is offered both with current term insurance coverage and without (the so-called wrap around) to groups with either under ten lives or ten lives and over. Higher rates are charged on the under ten life product for both the one-year term insurance and the fund deposits.

Guaranteed issue up to some fairly large amounts ($400,000) is available only on wrap around coverage with longer funding periods. In addition, guaranteed issue of both the term coverage and fund deposits is available for more modest amounts to groups who meet certain group underwriting criteria. Typically, the under ten life term and funding rates with a commission reduction are used to offset the anticipated extra mortality on the guaranteed issue cases.

Our RLR sales have been fairly flat since its introduction in late 1979. Our sales people attribute that to some outstanding legal questions about RLR gift taxes at retirement and the issue of possible discrimination in favor of highly compensated executives in some cases. In addition, the fact that the money is locked up in an RLR is very much a negative point. For these reasons it seems employers prefer to put their money in other vehicles, for example, executive bonus plans or deferred compensation, rather than RLR's.