RECORD OF SOCIETY OF ACTUARIES
1982 VOL. 8 NO. 3

PROGRAMS TO CONSERVE TRADITIONAL LIFE INSURANCE POLICIES

Moderator: MYRON H. MARGOLIN. Panelists: ELDON R. CANARY, BRADLEY J. JOERN

1. Efforts to combat replacement of inforce traditional life policies

2. Dividend illustrations on inforce policies

3. *Programs to increase life insurance amount on inforce policies*

4. Amendment offer to existing business to obtain market interest rate for policy loans and, as a result, obtain better net costs

5. Field compensation based on renewal persistency results

MR. MYRON H. MARGOLIN: Let me begin our discussion by reviewing some background data.

In 1951 the voluntary termination rates for all U.S. Ordinary inforce policies was 3.2% per year. This figure includes lapses and surrenders for policies of all durations. By the early '60s this rate had climbed to 5.2%. It reached 6% in 1972 and rose gradually after that until 1979 when it really began to accelerate: 7.2% in 1979, 8.1% in 1980 and in 1981 an estimated 9.0%.

The 1980 figure of 8.1% corresponds to about 12 million terminating policies. In the same year the U.S. life insurance industry wrote 14 million new policies. In a sense we took 14 steps forward and 12 steps backward - really not much progress - though in terms of face amounts the relationship is somewhat better.

Undoubtedly one of the important causes of this increase in lapse experience is a steadily increasing level of replacement activity. Yet hard data on this point are scarce. Conventional wisdom is that (1) about half of all lapses are now due to replacement or at least involve a replacement and (2) replacements are rarely, if ever, in the policyholder's interest. Here, mention might be made of a recent LIMRA study of 2400 households where lapse occurred. Final results are not yet published but preliminary data indicate that the first assumption is on target. 48% of the lapses studied involved no replacement; but 36% had already replaced a policy in connection with the lapse; and 16% were intending to replace a policy. Interestingly enough, however, only 29% of the replacement situations were recommended by an agent.

The second point, that replacement is rarely in the customer's interest, is increasingly challenged - first from outside the industry and more recently by certain segments within the industry - especially those specializing in specialty products like deposit term, term plus a side fund, universal life, etc. Whether this point is still valid - i.e., whether so few replacements are justified - is not really our topic today. Instead we will assume that companies have an inherent right to try to conserve their inforce policies against lapses including replacements.

So the question is: What are companies doing or what can they do to stem the increasing tide of lapse, surrender, and replacement?

Our first panelist will be Mr. Brad Joern.

MR. BRADLEY J. JOERN: Our topic is, or should be, one of utmost concern to insurance company management. The current environment is one of:

- o dramatic inflation,
- o high interest rates,
- o ever intensifying competition among all types of financial institutions, and
- o changing social objectives of the buying public.

All of these factors have resulted in deteriorating persistency, high policy loan usage, and increasing replacement activities.

Insurance companies have begun to respond to this environment through strategy-linked conservation efforts. I have seen at least three trends in the industry which indicate planned efforts to conserve existing business. There may be other efforts going on as well.

The first is a greater emphasis on the conservation <u>function</u> within companies. Most companies have had for sometime a small unit of employees whose primary purpose is to follow up on lapsed policies. Today, these small units have grown to full-scale operating departments. Trade journals describe at least the following:

- o New England Life is using computer terminals to quickly inform agents when a replacement form reaches the home office. New England Life estimates that about 35% of potential replacements are saved.
- o New York Life has held regional agent meetings to raise agent awareness to possible replacement.
- o Equitable of New York has created a Replacement Prevention Section in an attempt to save business vulnerable to replacement - they report an estimated success rate of 30%.

Second, companies are continuing to emphasize agent incentives that are tied directly to persistency, including:

- o persistency bonuses,
- o special internal replacement perquisites,
- o and others.

Third, a number of companies have enacted what I call structural conservation programs to conserve existing business. This type of conservation effort involves redesigning or restructuring existing policies. Some obvious and well-known examples include:

- o Northwestern Mutual Life - Get More Out of Life,
- o Pan-American - face increase,
- o New England Mutual - face increase,
- o Phoenix Mutual - More for your money,
- o ITT Life - planned redefinition of existing business forms.

Certainly other programs have been implemented or are currently being considered. A conservation program of this nature is not an easy thing to do. Its implications are far reaching, and intense planning must be undertaken in order for such a program to succeed. During the remainder of my remarks, I will be focusing on the major issues that must be addressed by insurance company management prior to developing a structural conservation program.

The first question that I asked myself when I became involved in the topic of structural conservation programs is: "Just what is the purpose of trying to conserve existing business?" Sounds simple enough.

I believe the principal purpose is preservation of the <u>value</u> of the existing inforce. This is done by financially solidifying the inforce from all perspectives:

- o the policyholder must believe the policy is a good buy and meets his or her needs in today's environment,
- o the agent must be compensated fairly and appropriately for his or her efforts in selling and servicing the business, and must feel company support for those efforts;
- o the company must realize an adequate return on its investment of capital.

Financial solidification results in:

- o avoided loss of premium income,
- o avoided capital losses due to forced sale of undervalued assets during periods of cash flow squeeze,
- o avoided potential dividend inequities caused if existing policyholders have to finance losses caused by replaced business,
- o improved long term incidence of lapses and loans, and
- o increased long term net gain and surplus contributions.

While I believe that preserving the value of the existing business is of primary importance, each company must prioritize its program goals based on its unique set of characteristics, needs, and desires. Additional program goals might include:

- o motivation of agents to <u>effective</u> conservation and internal replacement activities, and
- o coordination of past practices with new directions as reflected in new product forms and new corporate structures.

Each company should identify its goals, and financially quantify the key items in its conservation program, all the while properly balancing the needs of the company, the policyholder, and the agent.

Any company considering a conservation program of major proportions must understand that such a program is not a one-time, short-term reversible step. Rather, it is an integral step in a long range effort to preserve existing in force value. Such a program should be consistent with the company's long term objectives and strategies. Current conservation programs and future conservation programs must fit together.

The program should fit into and positively impact the various functions, processes, and forces inherent in the workings of an insurance company. A conservation program must not run counter to the forces driving the company, but rather it should be designed to take advantage of the opportunities created by these forces. It must not disrupt the functions which make the machinery work. It must not interfere with the processes which guide the functions in order to capitalize on the forces. Obviously, careful coordination and open communication are vitally important in the design and implementation of the program.

Which brings us to identification of some of the specific design issues involved when a structural conservation program is addressed by an insurance company. The company's position on these issues will be influenced by its overall program goals.

I have already mentioned the programs of a few companies. With one exception, the contractual adjustments of those programs have been some combination of:

- increased face amount,
- constant premium,
- enhanced cash values,
- slight modification of future dividend scales, and
- policy loan interest rate changes.

The one exception that I mentioned is ITT Life which appears to be converting its current policyholders to a product similar to Universal Life. The choice of adjustments is dependent on the company's posture regarding a number of the remaining issues.

Another issue that needs to be addressed is segmentation of existing policyholders. In other words, to what group of policyholders should a conservation program be offered?

- All in force?
- All permanent? What about paid-up?
- Restrict to certain issue years?
- Restrict to certain size policy?
- Restrict to certain products?

The choice should be made on the basis of such things as:

- segment vulnerability to replacement,
- segment sensitivity to change,
- cost/benefit relationship of the offer, and
- internal human and computer resources of the company.

What about the agent? To what extent should he or she be involved in the conservation program? That degree of involvement may vary directly with:

- the nature of the contractual adjustments,
- the perceived need for face-to-face policyholder contact,
- real versus perceived agency needs, and
- distribution system used.

If the agent is involved, how will he or she be trained? If the agent is to meet face-to-face with the existing policyholder to explain the program, two things must precede that meeting:

- the agent must understand the program, and
- the agent must believe in the program.

If the agent is involved, how should he or she be compensated? Any compensation scheme must be consistent with the company's overall compensation philosophy, and must properly reflect the agent's efforts.

Another important issue is that of equity among policyholders. This is obviously crucial to a program developed within a mutual company. Some of the questions which these insurers must address are:

- How will equity among policyholders be preserved?
- Can policyholder segmentation cut across dividend classes and not disturb equity? i.e., segmentation by issue year or size.
- Will policyholders to whom the program is not offered be subsidizing the cost of the program?

The methods used to approach those state and federal officials who have an interest in the insurance industry must be carefully chosen.

State insurance regulators will often require evidence that structural change programs are reasonable and fair to policyholders. Potential problems may be avoided if an organized, documented approach is presented to the regulators.

The IRS will be interested in the potential tax implications of a program. Companies should consider obtaining a private letter ruling if reserve interest rates are increased.

Another consideration is cost. A conservation program of major proportions is going to be expensive; not only in terms of development costs, but also in terms of present value of future existing inforce profits as they are influenced by contractual adjustments.

Since large amounts of money are involved, companies will <u>not</u> want to enter into a conservation program without some idea of that cost. A place to start would be to quantify the cost of projecting current adverse trends in persistency, mortality, and policy loan activity. Call that cost \$x.

Enacting a structural conservation program in order to restore the persistency assumption to its original pricing level and thereby reducing $x requires the balancing of various considerations. Some cost elements of a program would include (but not be limited to):

- o increased exposure to mortality risks due to increased face amounts,
- o enhanced cash values and surrender benefits,
- o potential capital losses if liquidation of assets is required to get the program off the ground, and
- o agent compensation arrangements involved in the program.

Some sources of financing the program would include:

- o tax savings resulting from increased required interest deduction if valuation interest rates are raised,
- o enhanced company image resulting in
  - improved policyholder satisfaction and persistency improvement, and
  - improved agent satisfaction and lower turnover,
- o modified policy loan features, and
- o a program of internal replacement or conversion to a quasi Universal Life policy form can be partially financed by the specific design features of the new product such as:
  - loads (annual and on invested cash value), and
  - the mechanism of crediting interest to the policyholder fund.

Quantification of the costs and financing amounts allows the company to balance these elements. The resulting program cost can then be compared to $x to answer what I have termed the vital financing question, i.e.

> "How does the cost of a conservation program which enhances the long term strategy and value of the company compare to $x, the cost of doing nothing?"

A few questions are appropriate regarding the timing of the program.

- o Is there an ideal time to introduce?
- o What else is happening within the company that would influence the timing? e.g.,
  - new product introduction,
  - dividend scale revision,
  - purchase or formation of a subsidiary, or
  - entry into a certain tax phase.

The timing of a conservation program should fit into the long term strategic plans of the company in such a way that it coordinates with the other elements of those long term plans.

Company management will want to consider the influence that the program will have on company image. Image is a part of the company's long term goals. A company must determine:

- o what the current image is,
- o what the desired image is, and
- o how a conservation program will help the company attain the desired image.

The best conceived program will be hampered in its effectiveness by poor communication to the policyholders.

Whether it be presented through the agent or otherwise, the insured must be able to understand the program relative to:

- o its specific short and long term impact on him or her, and
- o the reason why the company is undertaking the program.

The policyholder should come away from evaluating the offer with a positive image of the company and the program.

These are some of the general issues that I believe are critical in anticipation of a structural change program. These issues should be addressed as a part of the planning process leading up to program introduction.

I told Mike I would make a few comments regarding the implications of a conservation program for a stock company versus a mutual company.

On the stock company side, a primary issue will be satisfying stockholder expectations. Will they be willing to invest capital and short term gains for a long term enhancement of company value?

In addition, certain GAAP accounting questions are raised where contractual adjustments are implemented; particularly when policyholder segmentation cuts across GAAP assumption eras. Maybe some of you have given this some thought already and would be willing to share your ideas. On the mutual company side, I have already mentioned the ever-present question of preserving dividend equity between enhanced and non-enhanced policies.

Mutual companies with stock subsidiaries will want to consider the opportunities provided by this corporate structure. If a stock subsidiary is being used to market a Universal Life type product, actions similar to those undertaken by ITT Life are possible, but not without important considerations. One consideration is the act of transferring assets from one company to another. This raises questions concerning:

- o potential asset liquidation on transfer, and
- o potential imposition of state premium taxes on transferred assets if they are considered as premiums.

Another consideration would be potential benefits of the subsidiary's tax phase.

In closing I want to reiterate that an increasing number of companies realize that conservation is part of long term company strategy. This is evident by the recent efforts we have seen relating to:

- the internal conservation function;
- agent persistency compensation; and
- structural conservation programs.

I hope you are all thinking about conservation of your business. Mr. James Vineburgh of Connecticut General was quoted in the June 1981 issue of Best's Review as saying, "Any company not thinking about it is not thinking." I would like to add this: "Any company not doing something about conservation may not have to think about it much longer."

MR. ELDON R. CANARY: Conservation of business is a vital issue for most companies. In its conservation struggle, a company must find ways to benefit from the economic cycles, to fight replacement artists from other companies, to guide the ever more intelligent public in their decision making process, and to smooth the rough spots in certain areas of agency operations.

A company's vitality generated by persistency can disappear because of surrenders, replacements, lapsed policies, exchanges to smaller premium policies (although this may be better than losing the policy), and because of policyowners who maintain low yielding policy loans. To prepare this material, it seemed necessary to compare Franklin Life's operations in these areas to the operations of other companies. I was pleased to find that our operations compared favorably with other companies observed. However, this is not meant to imply that any of us should be satisfied with our operations in these areas. Franklin's management is obviously not satisfied and we are developing programs meant to improve the persistency of our business.

So that my comments are meaningful to you, I will give a brief description of my company. Franklin Life is a stock company emphasizing participating and non-participating ordinary life insurance and annuities through a general agency marketing system. We have over 1.2 million individual life insurance policies in force that provide over $15.3 billion of insurance coverage.

The annual statement of a company provides significant information in most areas of persistency. However, the statement does not provide information relating to policies that have been through the replacement process. This was an area that I was unacquainted with and decided to research.

Statistics are quite difficult to develop for replacements because of many reasons. One reason is that laws differ from state to state or are nonexistent and therefore consistency of data is impossible. It also appears that what might be replacements sometimes go unreported. The replacement laws are relatively new and statistics are available for only a few of the most recent years. Also, statistics differ from year to year because the number of states with replacement laws keeps changing.

My company has a monthly replacement report which reports the number of policies replaced during the month and for the year-to-date. The report is separated into three summaries. The first summary is by state, the second is by sales region and the third is by replacing company.

We are thinking of providing more significant data by including such items as replacements of orphaned business and replacements by plan of insurance; by duration since issue; by writing agent; and by current servicing agent. These reports will include both face amount and premium in each summary category. Some of this additional information is needed to determine the true loss to the company.

Another report that could be quite valuable is in the area of reporting those policies that have been conserved. Conserved policies might be difficult to identify and care is needed when developing your conservation rules to avoid reporting conservations that really are not true conservations. Information of this type would be most useful when summarized by servicing agent. With information of this type, additional field recognition could be made either in monetary form or honorary form.

We plan to provide summary reports measuring persistency for conserved business by duration since the conservation. Reports of this type could provide significant insight into the true value of our conservation programs.

Other types of reports could be developed to fit the needs of the company. A useful by-product of these reports is that they provide management with the opportunity to recognize trends as they begin to develop and to take necessary corrective action. Action might be needed at the individual agent level or at the sales region level. Action will be needed at all levels anytime a new program is initiated.

Using our statistics, I was able to make a limited analysis of the replacement of our policies by other companies for the years 1980 and 1981. The reported replacements increased by over 48% from 1980 to 1981. Much of this increase can be attributed to the fact that the number of states with replacement laws increased significantly during that period. We therefore received more replacement notifications because of increased state requirements. However, I do not feel we can minimize the problem by saying it is really not increasing, that it is only because of state requirements that we now record more replacements.

An analysis of the top twenty replacing companies provides some very interesting results. For example, the number one and number two companies on our 1980 list remained in those positions for 1981. Only three companies on the 1980 list moved up the list for 1981. Eight of the top twenty companies in 1980 were not in the top twenty for 1981. What do these statistics mean? I think I observed the answer when I looked at the actual companies comprising the two lists. There were ten companies on our 1980 top twenty list that were also listed in the 1979 Fortune 500 Directory of the 50 largest companies ranked by assets. Only six of these companies were on our 1981 top twenty list. I hope this leads to a correct assumption that most of these larger companies were on the list mainly because of the number of soliciting agents in the field and not necessarily because of a concentrated replacement effort. On the other hand, the most active group of companies seems to be comprised of smaller companies that may be working hard at replacing other companies' business.

To illustrate, the number one company on our replacement lists for both 1980 and 1981 was not in Fortune's Top 50 and that company increased reported replacements of my company's policies between the two years by almost 103%. This 103% compares to the all-companies increase of 48%. The number two company on our replacement lists for both 1980 and 1981 was a large mutual company that increased its replacement activity by only 20.9%. Also, the number one company replaced over six times as many policies in 1981 as did the number two company. Finally, the number one company replaced 24% of all reported replacements in 1981. That means about one out of every four of our reported replacements are because of only one company. I feel we need to develop a conservation program designed to counter this company's activities.

Franklin Life's management has recognized the need to develop programs designed to increase the persistency of our business. Within the last two years we have introduced two major programs affecting both participating and nonparticipating policyowners. These programs were designed to improve policyowner attitudes and to help improve the already positive client-company relations. Overall policy persistency will improve with the success of these programs. The approach in both programs was to increase the policy benefits and then to use good public relation techniques to inform everyone involved.

The first program involved our participating ordinary life insurance and annuities. The key element in this program was a major shift in our dividend calculation methods. We changed to an Investment Year Method (IYM) for the interest element of the three factor dividend formula that we use. We also changed part of our expense element to a per policy basis instead of a per unit basis to make our scale more equitable for policies with large face amounts. A very important feature of this program is that our approach makes it possible to treat existing business in the same manner that we treat new business. Our dividend illustrations for existing business are prepared using the same techniques as those used for new business. Therefore, the illustrations for existing business have similar IYM effect that our new business illustrations have.

Another important feature of this program is our treatment of policy loan investment income. Since the investment income from policy loans currently contributes less to distributable surplus per dollar of investment than do other investments, we felt this needed to be recognized in our dividend scale. We therefore introduced direct recognition of policy loan investment income for each individual policy. By doing this, we feel we are greatly improving policyowner equity since the nonborrowers do not pay for the activities of policyowners who borrow against their policy. Additionally, this helps improve the reliability of our dividend scale since a large unexpected increase in policy loans will not affect the interest rates in our dividend scale.

The direct recognition is used in the dividend illustrations for policies that currently have a policy loan outstanding. We assume that the current loan remains constant in all future years. Our procedure is that loan repayments are credited with the general dividend interest rate for the year of repayment. This can be done because the repayment is new money for general investment purposes. This provides an incentive to the policyowner with a long term policy loan to repay the loan. In turn, the company and the agent have a satisfied policyowner. We are currently in the process of developing an illustration that shows the effect of policy loan activities as an aid to the policyowner in making policy loan decisions.

Since this major program involved very important procedural changes, we felt obligated to ensure that each existing policy owner would receive a dividend at least as large as he would have received if we had made no change at all. This was accomplished by using the existing dividend scale as the minimum dividend. The minimum dividend is increased when a policy's distributable surplus exceeds its minimum dividend. If a policy's distributable surplus is less than its minimum dividend, the minimum dividend is paid and the overage is recovered from future dividends. This important feature has allowed us to avoid reducing our dividend illustrations for existing business below the values illustrated prior to the inception of this program.

We currently provide policy value illustrations when requested by a Franklin agent. It appears that we will prepare almost 800,000 illustrations in 1982. Since the illustrations are important, we plan to automatically include the illustration as part of an annual policyowner review. Policy illustrations will probably continue to play a very important role in future conservation programs.

We provided educational sessions for our agents and introduced our dividend program to our policyowners through an informational brochure called the "Franklin Update." This material was prepared in a question and answer format that tried to touch on the important features of the program. The most significant aspect of this educational material was that it placed the policyowners on notice that their future loan activity could have an effect on their future dividend values.

The second major program involves our nonparticipating business issued prior to 1974. The emphasis of this program is in the area of increased death benefits on a term insurance basis. For a policy to qualify for the increased death benefit, it must be a non-tax-qualified permanent plan of insurance that is currently premium-paying or fully paid-up.

The amount of increased death benefit for a qualifying policy is calculated as one-half of 1% of the face amount for each year or fraction of year the policy has been in force. Policy loans are recognized and the death benefit increase is adjusted in proportion to the amount of policy value that is loaned. However, the minimum additional death benefit is $25.

The program is reviewed periodically by the Board of Directors of the company. This means that the program may be either expanded or retracted at any time. Since Franklin is a mature company with many long term policyowners, this program has significant impact on the death benefit payments for many beneficiaries. We anticipate that this program will provide additional payments to beneficiaries of approximately $1,000,000 during calendar year 1982.

We introduced this program with a brochure that was sent to the policyowners. Again, the information was in a question and answer format that tried to cover all of the important points of the program. As an illustration of the potential value of the program, the brochure contained a sample calculation. The example was for a $10,000 whole life policy issued in 1950. The additional benefit to the insured's beneficiary is $1,600 in 1982.

In addition to the two major programs described, we have introduced a number of programs designed to produce very specific results. The first of these programs that I will discuss is called our "Surrender Conservation Procedure." This program includes the following important elements:

1. A conservation letter is sent along with the surrender form to the policyholder after we receive surrender communication.

2. Notification is made to the agent that the Home Office has received a surrender request. This notification contains basic policy information, a timetable for surrender activity, and a policy illustration. Out hope is that the agent will review the policy with the policyowner so that the policyowner will have adequate decision making material.

3. Teamwork between the field and Home Office is stressed.

4. Suggestions from the field are solicited.

Since this program was introduced quite recently, it is too early to determine what success rate this program will have. However, our agents have said they are very excited about the program. Persistency is important to our agents because their renewal commissions, bonuses, club qualifications, and other important items are determined, in part, by using a persistency factor.

The surrender conservation program could be expanded to include policy loan activity. The emphasis here would be similar to that used in case of a surrender. After all, a maximum loan that causes the policy to cancel by indebtedness is really the same as a surrender when persistency is measured. We have another program that is labeled "Simplified Reinstatement Offer." This program applies to all life policies that are on Regular or Family Premium Billing. When the policy has insufficient value for an automatic premium loan, a Simplified Reinstatement Offer is sent to the policyowner 40 days after the premium due date. The agent is also sent copies of the offer so that he can contact the policyowner for the purpose of discussing the reinstatement.

The terms of the Simplified Reinstatement Offer are as follows:

1. The insured and owner, if other than insured, must sign the form.

2. Payment of all past due premiums must be made as indicated on the form.

3. The form and payment for the past due premiums must be received in the Home Office during the lifetime of the insured and within 19 days of the date the offer was mailed to the policyowner.

4. The insurance coverage of the policy during the offer period is lapsed. Insurance coverage resumes only after all terms of the offer are satisfied.

Our desire is to have a sufficient cross-section of insureds to accept the offer so that evidence of insurability is not needed. The two year contestable period is waived.

Another program worthy of mention is our policy loan repayment program. This program provides for direct policy loan repayment solicitation by the Home Office with support from the field. A solicitation letter is sent to any policyowner that has a loan of over $100. The letter indicates that we will bill for a partial policy loan repayment of at least $10.00. A copy of the letter is also sent to the agency associate. If the policyowner begins a loan repayment program, an indirect positive result occurs at the end of the repayment period. The result is that the agent then has an excellent opportunity to sell a new plan for a premium amount similar to the periodic loan repayment.

The programs previously described should be successful because they have the elements needed for success. The elements of a successful conservation program include the following items:

1. Acceptance of the program by the field is necessary.

2. A significant amount of field involvement is needed in certain situations and suggestions from the field should be solicited.

3. Sufficient field incentive to provide service will need to be present when the agent is involved. Persistency clauses in the agent's contract might be sufficient or additional compensation may be necessary.

4. The program must operate smoothly at the Home Office level.

5. Communication from the Home Office to the field must be on a timely basis and the material sent with the communication must be accurate, self-contained, easy to use, attractive in appearance, and acceptable to the field.

6. The company should establish designated areas in the Home Office to handle this material and staff the area with qualified personnel.

There are many other programs that could be used to improve persistency. One such program would involve a concentrated effort to reassign orphaned business as soon as possible. Benefits obtained from this type of program would be that the policyowner would have a feeling of continuity as well as a contact for service. Additionally, the new servicing agent would have a potential client for a new sale.

Another approach could involve pooling the service fees from orphaned business by geographic region and paying a service fee for each service call. The region might be required to demonstrate that a certain number of service calls relative to the number of policies in the region actually occur to keep 100% of its pool. A potential advantage of this approach would be that the service payment could be large enough to truly compensate the agent for his time and expense incurred during the service call.

There are many other programs that could be undertaken to help improve persistency. I would like to again emphasize that Franklin Life has a sincere interest in conserving existing business. I hope that the information that I have given you today concerning my company will assist you in your conservation efforts.

MR. HOWELL W. PUGH: Mr. Canary, what rationale are you using for recognizing policy loans in the dividend allocation on your old policies?

MR. CANARY: First, our primary concern was equity for the policyowners. Next, as I am sure you have all heard many times, policy loans are an uninsurable event. In a sense, when a policy loan takes place, the policyowner is making his own investment decision. As such, we felt that it was necessary to recognize such activity in our dividend scales. Finally, at the time we introduced the program, we felt that any policy loans which were outstanding at that time should not affect future dividends.

MR. PUGH: Were there any perceived legal restrictions that Franklin Life had to overcome for the old policies, where you are in effect making a dividend philosophy change, or a dividend scale change which has retroactive provisions for your classes?

MR. CANARY: I think we can look at this process as not being retroactive because we began where the business was at the time. We converted our entire master file of over a million policies so that each master record contained all of the activity for that policy in terms of segmentation theory. We established an initial record which labeled for that individual policy how it stood in terms of cash value buildup, dividends on deposit, all of the other different aspects of the policy, and, of course, the policy loan. Therefore, including the policy loan on the initiation date, we felt was not retroactive.

MR. JAMES W. PREBLE: Our statistics tend to parallel yours in showing that a particular small stock life insurance company has a surprising effect on a company's total replacements. I might comment, though, that fending off such replacement activity of a specialty company and specialty agent is not that easy anymore. For some of you who may not be familiar with the replacement regulations and may think that they inhibit replacements - not so, not for the replacement company! There is notification needed, there are comparisons needed, but these can be learned and these can be furnished. It is not so easy, however, for the company whose business is being replaced to meet those same replacement regulations standards. You cannot just go out and fend off that replacement artist. Learn what those replacement regulations require of you before you develop your conservation programs.

MR. BRUCE CARLSON: Mr. Canary, first of all, you mentioned that past policy loan activity will not affect future dividends but future policy loan activity will affect future dividends. Is the same true for loans generated by automatic premium loan provisions?

MR. CANARY: That is correct.

MR. CARLSON: Also, you mentioned that in your three factor contribution formula you used the invest year method for the interest element. How does this work on a policy anniversary? Do you calculate tables of dividend per thousands and apply those against the base amounts of insurance? Or, is it formula driven and on the policy anniversary do you actually make a calculation of that interest element in your dividend formula?

MR. CANARY: Our calculations take place in two levels. The first level is a dividend based on per thousand of face amount, and the second level is calculated based on actual values of the policy which have already been converted to face amount values. We recognize the actual growth of each policy, and this is added to the minimum dividend.

MS. JOYCE A. TOLLEROD: Mr. Canary, could you expand on what kind of dividend illustration you use on existing business as opposed to new business?

MR. CANARY: Because the same program handles the calculations for both new and existing business, I would say that there is no difference between the two. As I described awhile ago, on our master records we established a beginning point for each policyowner. That beginning point reflects the current values of the contract. In a similar manner, on a new issue those beginning values would be all zeros. Now in terms of preparing a dividend illustration, the investment year method requires us to recognize investments as they emerge. To determine the interest element, we would apply the appropriate investment year rate to the fund at hand. Keep in mind, however, that on existing business we will have these additional contract values to help describe the emergence of the fund.

MR. LEW H. NATHAN: Could any of the panelists make a few comments about internal replacements policies that they might have in effect? For example, a simple example might be rewriting some of your retirement income policies for ordinary life, or if you have universal life, perhaps shifting some of your business internally from one of the prior forms to that form.

MR. JOERN: I certainly think that companies are internally replacing their business - whether it is planned or not. For instance, I have a term insurance policy with a company. A month ago I received a letter from my agent indicating that they had a new policy with a lower rate and asking if I would want it. I responded, of course, yes I do. I later received a follow-up call from someone, I do not know if it was from the company or not to be quite honest, asking me whether the new policy I was applying for was replacing another policy. Now to me that is internal replacement. I would also call the program described for ITT Life as being some sort of internal replacement program.

MR. NATHAN: Let me just follow up and ask Mr. Canary if you have considered internal replacement policies as well?

MR. CANARY: We have considered internal replacement out of necessity, I should say, because of many different new product innovations that have come along. One for example, might be our new 20 year select and ultimate term insurance policy. At the time, we had been issuing annual renewable term insurance of similar benefit. When this new product was introduced, rather than allowing existing policyowners to lapse and to go to another company which had a similar product, we told the agency force that we would entertain changing the existing contract to this new plan by keeping the premium the same and increasing the death benefit if the insured qualified. In general, I would say that we have not had a large internal replacement program, but in instances we have felt it necessary to do so.

MR. ANTHONY SPANO: In the regulatory area, we are seeing regulations being proposed which would eliminate the comparison form that has long been a staple of the replacement regulations. Some reasons why these comparison forms have been eliminated include the feeling that they perhaps do not accommodate the new products and the feeling that so many of them are inaccurate that they are not of much value anyway.

MR. JOERN: Although I do not have direct experience in this area, it is my understanding that many of the comparison forms do come in with erroneous information on them. On the other hand, the comparison forms can be used by the original issuing company to show the client a valid comparison and to point out to the client where the original comparison may have been wrong. Until we can get to the point where misrepresentation is gone, I would vote for maintaining the comparison forms.

MR. CANARY: I interviewed our replacement officer in my company, and he also indicated that he encountered inaccuracies on the forms. However his comment was that no matter how inaccurate they are, they are notification and they do provide the original issuing company with the opportunity to be aware of the replacement activity and to try to reestablish the benefit of the original contract.

MR. PREBLE: My efforts at looking at replacement comparisons show the great difficulty in using them effectively at all. They are submitted incorrectly, and the agent that submitted them is not subject to any penalty. The company whose business is being replaced has the obligation, if they want to use that form, to correct it. As a practical matter, the replacement form does not help the company whose business is being replaced nor do they inhibit the replacement artist. I think notification is important, but I would like to see the replacement forms be done away with.

MR. DAVE JAEGLER: I am part of a task force in Ohio, which is made up of agents and home office representatives, considering this very question. We do feel that the comparison replacement form is not being used very well, and, in fact, gives many agents reason to say there really is no replacement involved. The proposal we are considering at the present would require the replacing company to send a policy summary to the existing company that would be either in the form of a ledger statement or maybe the same type of policy summary which is required when the policy is delivered. This would provide notification which the existing carrier could then use in trying to combat the replacement. Both the agents and home office representatives felt that this would be a good solution.