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INDIVIDUAL TERM PORTFOLIO MANAGEMENT

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- Portfolio management
  - Role of term products
  - Relationship to distribution system
  - Relationship to other products
- Monitoring experience
  - New business
  - Inforce
  - Deferred acquisition asset problems
- Current new product trends
  - Preventing replacement
  - Pro's and con's of internal replacement
  - Conversion to interest sensitive products

MS. DENISE FAGERBERG: A few weeks ago I had lunch with an actuary from a large South African company who had been in the United States to learn more about universal life. Over lunch he asked me what else was happening in the U.S. Life market, and I told him that the market had been dominated by select and ultimate term products in the last few years. After I had confirmed what the premium patterns were and told how low the prices had been, he asked me what sort of first year compensation we paid. And I said, oh, anyplace between 50 and 100%, and he was just incredulous. "That's crazy", he said, "why would anybody do that?"

I thought that was a very good question, and I hope that's one we answer today. I think we have a very exciting panel for you. The major thrust of our session will be to explore why companies write term insurance. We'll also look at the implications of the large potentially explosive blocks of inforce term business that many of you might have. And we'll also discuss product design features, and their marketing and experience implications. Lastly, we'll explore replacement problems.

Each panelist has prepared thoughts on all of the topics. Given their diverse backgrounds, I think we should have an interesting discussion.

Our plan is to tackle one topic at a time, and open the floor for questions and comments. In fact, right now, we have our first audience participation question. How many of you represent companies who have not raised term rates, lowered term commissions, or entered any underwriting for persistency programs in the last 12 months? If you would, please raise your hands. Oh good, there are several of you. You can tell us what you are doing right during the course of the session. My plan is to get you to participate and ask questions, and we think it will enhance the program for everyone.

We are going to begin at the beginning. Just as every organization needs a mission statement outlining its reason for existence, I believe that term products often need some sort of mission statement. Before a company can begin designing a product, they must decide why they need the product, and what they're going to accomplish by writing it, rather that just going out and doing what everybody else is doing. This analysis would include examining the needs of the agents and the potential policy-holders, as well as the needs of the company. In the course of examining these needs, I believe they will be able to develop a product that will help them meet their goals.

MR. FRED JONSKE: I would like to give the perspective on the term portfolio from really two perspectives — first, from the perspective of a large multi-line insurer with a captive career agency force, which is represented by Allstate Life Insurance Company, and secondly, that of a small life insurance company utilizing the independent agency system. Lincoln Benefit Life is a wholly-owned subsidiary of Allstate Life Insurance Company, specializing in the PPGA brokerage distribution system. I might add, just going back to Allstate, that another important ingredient of that career agency system is that it is an exclusive contract of that company. I might also add that from an interesting perspective, neither of these companies have entered the select and ultimate term market as of this date, although both companies have sold proportionately large amounts of term insurance.

From an industry standpoint, term products have and will continue to play an important role in the life insurance marketplace. Over the past decade, term insurance sales have consistently represented about fifty percent of the total ordinary or personal life sales. Term sales numbers actually are sometimes hard to verify, as you probably all know, because of the fact that the classification of graded premium whole life contracts are generally classified with whole life sales. You might have received recently the Best Management Reports which said that in 1983 term sales increased by slightly over 20%, which was the largest since 1980.

Although term insurance has remained popular, term sales have fallen off relative to other ordinary life sales. Again, according to Best, the ratio of term insurance sales to total ordinary life sales has fallen for four consecutive years, from a peak of 56% in 1980, to 44% in 1983, and to no surprise, this fallout has been attributed to the increase in popularity of universal life.

Term insurance, however, has always been popular, and will continue to be so. Why is this? From the consumer standpoint, you have the basic public desire to minimize their initial premium outlay. This will continue ad infinitum. There are those people who will only want to buy term insurance, perhaps under the term-and-invest-the-difference scenario. Another term market out there, from a consumer standpoint, is to satisfy insurance needs which are of a limited nature, such as to cover loans. We may, at times, forget this market, but it is a successful market for companies.

While the preceding reasons for term popularity have been precipitated by consumer demand, we have also recently seen the distribution system, and this is basically the agency system in total, stimulate sales. Reentry term with the select and ultimate mortality rates and heaped first-year commission rates, has encouraged agents to sell term insurance frequently, not unlike stockbrokers who have an incentive to move their accounts on a frequent basis.

Each of your companies must determine what role the distribution system and term insurance have in your companies. The distribution system is paramount. The distribution system has considerable influence on the management of a term portfolio. For example, if you're a company like Allstate, which has a captive multi-line agency system with an exclusive contract, you can resist product fads such as reentry term, or at least product designs which have a high degree of risk from the company's vantage point. You can also argue that problems with reentry term were really a byproduct of the environment. In saying this, we are talking about having perhaps too many agents in the 70's and early 80's capturing a declining percentage of the disposable personal income. If you actually look at the ratio of ordinary life premiums to disposable income, perhaps it is not a surprise that we have had a steady decline from about 2.5% in 1960, to a low of about 1.6% in 1980. Interestingly, that figure actually rose two years thereafter in '81 and '82, but, I guess to my surprise in '83 it dropped again back down to the 1.6% area. You could say that this declining ratio has lead insurance companies to design select and ultimate term products which inadvertently subsidized both agents and consumers.

A multi-line insurer like Allstate is somewhat insulated from these market aberrations. The average Allstate agent earns less than 10% of his or her total income from life insurance. Most life insurance sales are strongly tied to satisfying visible needs. The vast majority of the term sales made by these agents is to provide mortgage protection insurance. Annual renewable term insurance was not introduced until 1981, and then only with a commission scale that would not encourage that churning of business.

I wish to emphasize that Allstate's exclusive agent contract provides company management with a great deal of control, which companies dealing with an independent agency market don't have. On the other hand, if you are a small life insurer dealing with independent agents, you know you have to seek divine intervention to try to find some scenario with which to come out with a term product that is both competitive and profitable to the company. A large market for decreasing term insurance usually is not possible for a small company. You can develop specialty products, such as deposit term, which has, again, a limited market at this point in time. However, inexpensive level term is still the name of the game if you choose to compete.

A small company also has the added disadvantage of being highly dependent on reinsurers. The profound change that reinsurers have undergone in their coinsurance pricing over the past three years has had a dramatic impact on companies who are dependent upon them. As a small company who is soliciting independent agents, you must compete in the marketplace, and your choices are wide. You know you can assume a high risk scenario, and price the term portfolio assuming items like improvement in future mortality, over the lifetime of a block of business. You could use marginal expense pricing, or even assume a highly favorable term conversion rate. However, we have found these assumptions too liberal to make.

Our strategy is basically to first implement an indeterminate premium pricing structure, where you can raise premiums as well as lower them; to adopt preferred risk underwriting, which may include simply smoker/nonsmoker, but may go beyond that in terms of other preferred risk categories; to adopt commission scales which do not encourage the replacement of business; and, finally to have design features which do their best to minimize customer advantages for replacement. Again, to put it all in context, you do have to look at your term products relative to other products in your portfolio, with regard to permanent policies.

Many term policies are designed to encourage conversion to universal life and other permanent types of policies. You can do this through granting premium credits on conversion, or by providing the opportunity to increase face amount upon conversion without underwriting. You can take this to a larger degree and actually price term products that assume the profit that may be derived upon conversion to permanent insurance. With respect to our environment, since Allstate's term sales mainly cover limited insurance needs such as to cover mortgage loans, the conversion rate for term policies is relatively low, and it is not a large factor for us. When dealing with independent brokers and agents in the small company scenario, which I am also representing, the term conversion factor has not had a significant affect on our pricing.

Lastly, you also have to look at your term products relative to other term products in your portfolio, because you may find that you may be encouraging or not encouraging anti-selection in the development of the policy. That, at least from my vantage point, is a quick synopsis of our perception of term policies.

MR. WALTER N. MILLER: Except for a brief, exciting, turbulent, fifteen month season in the sun from the fall of '82 through the year '83, the best way you could characterize New York Life is that we have been a relatively high-cost provider of term products. Unlike Fred's company, New York Life is one of those companies that has a captive field force. But that is a misnomer in our case, and term insurance, over the most recent ten-year period, is one area where we have really learned that.

If you want to look backward, I would say that our primary strategy with term had been to recognize that obviously, there are prospect and client situations where term is the right product to meet the current need -- you have to have some term coverages in your portfolio. We, for a while, followed a strategy of trying to get around the fact that we were far from the cheapest by having a great multiplicity of term coverages. We did things like coming out with fully flexible decreasing term coverages available for any term period, from 10 to 50 years. The print-outs of the standard paid issues reporting could fill this room with all these term periods. When we looked at these print-outs, we discovered that we practically never sold anything except for a 20-year period. We rationalized that by saying, well they wouldn't have bought the 20-year if the 18-year and 23-year products weren't available.

Our main strategy in managing our term portfolio in years gone by was to structure it in a way that provided the most conversion potential. This was certainly what our agents wanted, and we thought this was good for us and our policyholders too. For years, we sold a lot of five and ten-year level term, automatically convertible at the end of the period into whole life. That was not a New York Life exclusive, but we always wondered why more companies didn't pick it up. We were enormously successful, way back when, in having people swing over to whole life at the end of the term period. We used to have 80, 85% swing-over rates at the end of the 5 or 10 years. That's long since gone.

In the mid '70's, everything started to change, as "cheap term" became available in lots of ways, shapes and forms. In '74, for the first time, we introduced a yearly renewal term policy, once again, not particulary "state of the art" when it came to pricing. For a while that did pretty well for us, because it provided our then cheapest going-in rate. Just the product design change that came from going to a YRT basis from the five year term gave us a significant reduction in going-in rate, and that helped for a while. But that didn't work too well either, after a while, as developments that I think everyone in this room knows a lot about, drove term rates down, down, down.

Finally, in late '81, we introduced an indeterminate premium select and ultimate version of our YRT policy. The rates were not tremendously competitive, at that point. In August '82, we cut the rates, coincidentally with the codification of the new tax law, to something that was not the absolute lowest rates in the industry, but here began what I described as our season in the sun. We were fairly close to state of the art. Our term sales immediately doubled, except what we were realizing, of course, is they weren't our term sales, but they were the proportion of the term sales that our agents were always making, that they were deciding to put with the New York Life.

About this time last year, we looked at the developing scene, at the developing tax laws, and at the virtual certainty that 818-C treatment was going to disappear. We reviewed what we had heard about other companies' experience, we looked at our own experience, and we cried on each others' shoulders a little. We finally came to the reluctant conclusion that come the beginning of '84, in the new tax environment and so on, we had no choice but to raise our rates significantly on this policy. But we said to ourselves, "that's okay, because every other company in the industry, be they stock companies, or be they mutual companies, is going to be working under the same tax laws and subject to the same conditions, the same pressures, the same forces. Obviously they are going to figure things out in the same logical way that we are figuring them out, and when we raise our rates in January '84, everybody is going to raise their rates to about the same degree. They are going to have to, and everything will turn out okay."

We thereupon set a record for naivete, that perhaps can be equaled, but never surpassed.

As you would expect, our term sales, having doubled when we cut the rates to close to state of the art, decreased by about 50% pretty quickly. So one thing we know from this whole experience is that unless we somehow have perceived price parity with other companies, our agents are going to put about half of the term business that they write outside.

What is our strategy now? Part of our strategy, of course, is hoping that all of you will see the light and do something like what we did. I think there are two main new elements in our strategy. One is to try to teach our agents to sell products other than term in situations where term had previously been sold. Specifically here, I am talking about the fact that before the advent of universal life, there were many agent/client prospect situations where a need for insurance had been demonstrated and agreed upon. The prospect was then faced with a very stark choice, and that is the choice between paying, maybe a hundred or two hundred dollars going-in price for $100,000 if he buys cheap term, or paying $1200 to $1400 if he buys whole life. That is a very stark choice, and as we know, more and more people were opting for the lower payout. With univeral life, there is an alternative available, and we have gotten many of our agents to talk this up and be able to successfully sell universal life for maybe $600 to $900 in the situations where the stark choice used to be between $200 and $1400. This doesn't solve our problem in situations where the client says "I want term, and I want it on the cheapest basis possible", and we are just recognizing that.

The other part of our strategy, in terms of things we are doing differently now, is that we have introduced a not terribly aggressive program to "convert" term insurance written by a large number of other companies. At least here is a way that a company in our situation, who feels that they have a very difficult time maintaining parity in the term market from a price standpoint, may be able to defend a good chunk of our conversion potential.

MR. WILLIAM K. TYLER: About 15 months ago the Reinsurance Section and the Individual Product Development Section of this Society put on a seminar in Chicago. The subject of that meeting was very similar to the subject we are talking about today, and much of the discussion had to do with the emerging experience that many companies who were operating extensively in the term market were enjoying, or rather not enjoying. Since that time, there has been some significant changes in the development of the term market. From the perspective of some, those changes haven't been dramatic enough, nor pervasive enough, but nevertheless, some changes have occurred.

I would like to begin my comments with a question, and the question is "How well has the industry as a whole managed the term market over the last several years?". I've pulled together some facts, which perhaps are not news or revelations to anybody, but putting them all together does lend some answers to this question. From 1977 to 1982, the price of yearly renewable term decreased by about 32%. The market share of term sales, as Fred mentioned, has dropped as a proportion of total ordinary life sales to 44% in 1983, but it is still a very large percentage of the total market. Less than 2% of the term policies issued in the past 20 years are currently in force. The average term policy lasts about 2 years.

Now, statistics, (as one can appreciate in listening to the presidential debates) are not always what they seem to be, but I think the message is pretty clear from these pieces of information. The term product has obviously become very competitive over the last few years, and the experience the companies are getting in that marketplace is simply not at a level that they can afford to continue. If you look at these facts in concert with the depressed earnings that primary companies and reinsurers who have participated extensively in the term market have experienced, you certainly can realize that the industries' management of term portfolios has not been successful for all parties to the agreement.

On the other hand, most of the industry analysts or observers anticipate that term sales will continue to grow at an 8 to 10% annual rate over the next 10 years. This is not surprising in that term products do meet a legitimate consumer need for low cost death protection and for a situation, such as Fred mentioned, where a temporary insurance need exists. The industry simply must improve its ability to successfully meet the needs of this segment of the market, and success in this market has to be defined to take into account the interest of the consumer, the agent, and the companies.

I would like to speak briefly about Lincoln National Corporation's various distribution systems. The company is organized into fourteen strategic business units, each of which operates relatively independently from the other. As a leading life reinsurer, Lincoln has participated to an extensive degree in the term market, particularly during the last 5 to 7 years. Sales growth has been phenomenal, with an annual growth in the range of 30%, which we were happy about for the first few years of that period. Most of the new sales, probably in excess of 70%, have been term -- beginning with annual renewable term products several years ago, and then developing into the select and ultimate term and graded premium whole life products of recent years.

We deal with all sizes and types of companies whose interest in the term market varies. Our relationships with our client companies are very important to us as a reinsurer and we have been very interested in trying to operate competitively as a reinsurer in the term market to meet those needs and maintain those relationships. We are keenly interested in what happens to the term market in the future. We hope future growth will be more rational, not only for our benefit, but also for our clients as well.

The second distribution system in Lincoln National Corporation is the career agency distribution system, which is handled by Lincoln Life, out of Fort Wayne. The career agency division, a few years ago, attempted to manufacture a 7 year renewable and convertible term product. Prior to that time, the career agents basically had no competitive products to sell on the term side, and their primary sales were in the participating permanent area. The seven year term product was referred to by an acronym called "START". The program started very slowly, sales were not good, and I believe that product was in the field for a year to 18 months before it was withdrawn because of poor sales.

At that point, the division attempted to develop a select and ultimate ART product. It was not particularly competitive. The slope of the premiums were quite moderate, by competitive standards at that time. Despite that, sales were outstanding, so outstanding in fact, that the division people went back to their asset share studies to look at profitability and became very concerned that even though they were not selling what was viewed as a competitive product in the marketplace, they really didn't think that they could cover their expenses and have anything left over for profit contribution to the operation. I will give the career agency division a lot of credit here, I think the select and ultimate ART product lasted for six months.

At that point, during this period of time, Security Connecticut was purchased by Lincoln National Corporation, and the career agency division signed a national brokerage agreement with Security Connecticut to allow

Lincoln's career agents to broker term business through Security Connecticut. Essentially, Security Connecticut was able to offer more competitive products primarily because of lower overhead costs that they had to recover from the product. In any event, the career agency division had very quickly come to the conclusion that the best way to manage a term portfolio was to participate in the distribution profits, but leave the manufacturing profits to someone else. Simultaneous with this decision, the career agency division moved very aggressively to develop a universal life product, and has pushed that product and promoted that product to the distribution system for the last several years to the point where now in excess of 90% of all new Lincoln Life career agency sales is of universal life products of one form or another.

The third distribution system in the corporation that has been very much involved in the term market is Security Connecticut. They have been a leading writer of term business; they have operated extensively in the brokerage market. The term market is very important to them. It is an important product that is required in order for them to acquire and maintain brokerage agents. Security Connecticut has been successful in writing these products, but is at the same time very concerned about the profitability of the programs they are writing, especially in view of the persistency experience they have been seeing.

Finally, I would like to briefly comment on American States Life Insurance Company, which is a subsidiary of American States, Lincoln National's property/casualty Company. The American States Life Insurance Company distribution system is the independent P&C agents that American States has under contract. The challenge in this distribution system has been to get the agents to sell any type of life product: term, whole life, whatever. American States has been successful in motivating their P&C agents to sell universal life. For some reason that type of product apparently is a natural sale for these agents. In any event, they have been very successful in using this product. While term products are offered to this distribution system, the existance of a very competitive term portfolio does not appear to be a key requirement for American States.

As you can see, each distribution system places a much different importance upon a competitive term portfolio, and depending on the needs of that distribution system, each has reacted correspondingly. Obviously, the Reinsurance Division and Security Connecticut are the two areas where a real interest and need to operate in the term market does exist.

MR. MILLER: I would like to ask Bill, where did you derive the statistic that the average term policy lasts two years?

MR. TYLER: That information came from a LIMRA survey. I am not sure exactly what their statistical base was for making that conclusion, but it sounds long to me.

MS. FAGERBERG: I think Dr. Arthur Williams at Penn State University did a survey for LIMRA and found the average term policy was in force 22 months before it lapsed.

MR. MILLER: The average term coverage stays in force longer than that but transmutes itself in interesting ways in different companies. That is part of what we are here to cry on each others shoulders about.

MR. MICHAEL R. WINN: I have a question for Bill Tyler. Bill, would you like to comment on the trends in your termination rates by issue age and by duration and some of the characteristics? Secondly, I believe your Lincoln Reporter came out with a very interesting article on the underlying mortality that perhaps will emerge from select and ultimate ART type plans. Would you like to further comment on that, and are you beginning to experience any of that at the current time?

MR. TYLER: I didn't bring any statistics with me, Mike. In fact, after the last couple of years I have stopped looking at the emerging lapse rates. Ignorance is really bliss in this situation. First of all lapse rates on term products obviously vary a great deal from client company to client company. It depends on what kind of product the company was selling, how they marketed it, what types of controls they attempted to place on their agents, policyholder choice in terms of churning the business from one year to the next. But overall, for those companies who have been in the very aggressively priced term market, our termination rates have been very unacceptable.

We were looking particularly in the last half of 1982 and 1983 at termination rates that, for the overall block of term business, were rising to around 30% a year. Most of that business was still in early durations, but as the second and third durations started to roll around, that experience showed that the termination rates were staying at least that high, and in some cases, going higher. It is hard to make money on a product that is priced with very thin margins when persistency is no better than 70%, where pricing generally by both the reinsurer and the direct company assumed much closer to a 15 or 18% level termination rate. So, that level of termination activity was wholly unacceptable. In 1984, although I haven't looked at any statistics by duration and age to see how the specifics are developing, overall our termination rates seem to have stabilized. They are not getting worse. They are still at too high a level, but they do seem to have stabilized. I think this is, in part, a reaction to the cooling down in the term rate war during 1984. In addition, as companies have begun to underwrite for persistency, persistency rates have leveled off.

With respect to mortality, we haven't been able to see any specific trend in our mortality results that suggest that the anti-selection discussed in that Reinsurance Reporter article you mentioned has taken place. We have no doubt that it will happen, but it hasn't hit us yet.

MR. JOHN E. TILLER: Once upon a time, in the merry old land of Oz, I worked for a company that made a substantial amount of profit by selling term insurance, and then converting it as the economic conditions of the buyer changed. Presumably this is because of the great differential in price between a permanent policy in the merry old land of Oz, and term products. Is anybody today pricing for or expecting a profit from conversions? Are term policies ever converting or are universal life policies being sold on a low going-in basis, and should we be looking for term policies to stay strictly as temporary coverage? Anyone?

MR. MILLER: Well, as I indicated before, the days when we used to get 85% automatic swing over rates at the end of a 5 or 10-year period of level term coverage are long gone in the New York Life, but we are still getting a lot of conversions. In our situation though, when you are going to pay the same dividends on a policy that is bought as a conversion of term insurance as on one that is newly underwritten, we do continue to feel that it is not appropriate to look at potential profits down the line from conversions in pricing term -- with us it is the other way around. In situations where we feel the extra mortality cost, versus that on a newly underwritten policy is going to outweigh the underwriting expense saving, we charge for that in our pricing of the term coverage.

MR. TILLER: You are putting in a cost rather than an expected profit, if I understood that.

MR. MILLER: It depends on the age, John. You have to get above the 30's where there is a significant excess, but at those points, yes.

MR. TILLER: Fred, can you comment on the captive agency forces you have dealt with?

MR. JONSKE: Yes, as I have indicated, in the multi-line agency force that Allstate uses, we don't see a sizable amount of that type of term coverage converting and it is probably due to the fact that most of the people that buy term, buy in conjunction with their homeowners policies, and solve their mortgage loan needs.

I would just like to add a point here. Walt mentioned that he raised his rates recently, and I noticed in looking at Best Review of the past year or so, they have been having competitive analysis in that publication for different types of policies. If you look at just the last two studies for indeterminate ART policies, you would find that there were 43 companies, included in both comparisons back in, I believe, March and then in September, and of those 43, 39 companies showed no change, 4 companies lowered and Walt was the only one that raised his rates at that point in time. If you look at the graded premium whole life policies over a similar period, there were, I believe, 23 companies included in the comparison, 2 companies increased rates, no one lowered, and the rest stayed the same. So, I guess there is some moral to all of that.

MR. MILLER: Walt Miller's third law of corporate organization is that no corporation can function effectively without a clearly defined scapegoat, but I would like to state here for the record that I didn't raise the rates, the New York Life raised the rates. As a matter of fact, very shortly after this rate increase took place, I moved from the marketing department to strategic planning.

MR. HAROLD G. INGRAHAM, JR.: A question for you Walt -- a few minutes ago, you mentioned that you had a low-key program for converting other companies' term insurance. Could you shed a little more light on that, in particular are there any limits on the amount of insurance that you will consider, or length of time since the term is written, or perhaps the most important, the type of company that did the underwriting in the first place?

MR. MILLER: Yes.

MS. FAGERBERG: You can ask him that again in a few minutes Harold.

MR. DENNIS CARLSON: In light of the fact you asked for some comments, I will give you some of my observations. We are a Farm Bureau company, and therefore we deal with multiple line agents, career agents. Again, we don't know exactly what percent of the term sales come to us, but we have taken a posture that we need to offer, because of a career shop, an ART product that is reasonably price competitive, so that our agents can maintain some kind of customer control, and hopefully we won't lose too much money on it. Basically, we have done some experimenting. We are not the lowest, we have rates that we don't have to completely hang our head for, but they are also not embarassing I think industry-wide. However, I was sure they were losing money. Therefore, like a moth to a flame, I had to try to figure out the environment.

The first thing we did was to start tracking our lapse rates, and I would like to thank the BMA for publishing these studies they did. We found that, in spite of the fact that I think we have a pretty good career force, in terms of persistency, our rates were basically the same as BMA was publishing. Incidentally, our ART is attained age ART, no gimmickry in that regard, no select and ultimate. Also, being a P&C agency force, we have paid 25% first year and 10% renewals for the life of the product. I am sure that helps too, considering the lifetime of the product, but at any rate we have attempted a level commission scale, or as near to level as we can get, simply to induce persistency incentives and service incentives. We did a second study looking at one year's term conversions. We did not separate the data by age at issue, attained age or duration. We found that in that one-year period we had converted 15% of our policies by inforce, not by policy count. So, we felt that was pretty encouraging. This was pre- U.L. by the way. I would expect that with universal life that may go out because of Walt's comment that universal life suddenly makes life a lot better for everyone because now they have a range of premium choices under universal life.

One of the things that I wanted to do was to determine, given no competitive constraints, what is the right price for ART? I recently did some studies on an attained age product, I did some market or some pricing testing on a $250,000 male ART smoker, and a $250,000 male non-smoker, and then I did the same thing with a $25,000 policy. Our company incidentally allocates expense quite heavily towards per policy expenses, so that policy size would have a significant impact on price. We developed some prices that had wide variations. For example, at age 25, the price -- assuming we were going to get a modest profit as well as cover our expected mortality expenses, anticipation of lapses and a little bit of investment income -- came out around $1.80 per thousand for the smoker at a $250,000 size band with a $20.00 policy fee and about $5.30 per thousand with a $20.00 policy fee for the $25,000 band. Now anticipating that our marketing department might find this unacceptable, I figured there was some way I had to play with these numbers to make them happy, so I decided to use two equations and two unknowns and basically say, if we had the same per thousand policy premium, what kind of policy fee would we need? Incidentally, I did this over the range of ages 25 at issue to 55 at issue, and remarkably, the policy fee was very close to $100.00 per year, per policy, with a $1.70 premium per thousand for all amounts.

This is kind of attractive to me, kind of an interesting concept for two reasons. One is because people like to change their amount of insurance over time, assuming they persist. Going from one band to another is a mess administratively because you have to change the per thousand premium, or you really should at least, to give them the benefit of the doubt so they do not have to terminate and reissue if they are going to a higher policy size. The advantage of going with one premium per thousand in all bands is that you do not have to fool with that anymore, which is kind of nice. The second thing is even more attractive to an actuary who is bothered by the fact that you have to come in with an inadequately priced product that you would sure like to turn into an adequately priced product when the reinsurers stop playing games, and the other companies stop playing games. Maybe we can get to an adequate premium someday.

The proposal to management was that we use the same per thousand premium at all sizes and in the policy, we have a guaranteed policy fee, at say \$100.00. From a price competitive standpoint, we would use an indeterminate policy fee that is lower in the interim to take up the difference between adequate premiums and price competitive premiums, and then perhaps someday in the future, which may never arrive, if there are any of these policies left we could, in fact, raise the policy fee to an adequate level that might then put everybody on a parity. It would be a relatively easy thing to do system wise, rather than fiddling with per thousand premiums.

MS. FAGERBERG: We will move into talking about products now, and then to monitoring experience. I think right now there is a lull in the term market, and that this might be a good time for a company to carve out a niche for themselves in this market. I would like to ask our various panel members to discuss what they see as good term products.

MR. TYLER: Obviously, as we discussed before, there has been a big growth in the last couple of years in the sale of universal life and investment oriented products which have caused a share of the term business to decline. But there is a large term market out there, and there is a legitimate need for such a product, for the reasons we mentioned previously. Term sales will grow in the future as the population demographics develop over the next few years. As the baby boom generation reach their early 30's and start to settle down and have families of one form or another, they will be looking for insurance protection. Term is going to meet a real need in that marketplace, and it is an important one. That makes it all the more important that the new products we offer be priced and designed in a manner that can be successful for everybody who is participating.

As Denise mentioned, during 1984, the term "rate war" of the previous years has seemed to stop in its tracks to a large degree. Some companies have been raising prices, or levelizing commissions, but more needs to be done. Product development in general is moving along; there is a lot of activity on the product development side, for companies who are in the term market. The interest this year seems to be one of trying to identify products of a different form that may be designed in a way to be successful in terms of profit expectations to the companies while still maintaining a competitive posture, if that is possible. From a reinsurance point of view, we have seen as many if not more opportunities to quote on newly developed products, but unlike prior years, very few of the products we are seeing are select and ultimate in form.

Companies are showing renewed interest in attempting to develop attained-age ART products. They are looking at five-year and 10-year renewable and convertible term products as an alternative as well, and a variety of deposit term products are being considered. In addition, some companies are considering the possibility of the multi-year premium mode, in order to lock in persistency on the product for a few years in order to insure that recovery of acquisition costs can be accomplished. In addition, as Dennis Carlson mentioned, companies have been looking at the possibility of, or have been raising policy fees, and in many cases making that policy fee non-commissionable in order to levelize commissions effectively on the products.

We see some companies who are trying to develop a financial planning activity in their distribution system, where the fee income to the financial planner comes from the client, and is not built into the product. I think some companies will be moving in this direction, and certainly, it would be logical to think that as the banks and other financial service industries start to look at insurance, this would be a natural direction for the term product to go.

Finally, I think a term product might very well be a product that can be successfully mass marketed by a number of organizations. There are many organizations who are looking for ways to use direct response in one form or another to sell insurance, and it would seem that there might be some product designs and approaches that develop out of this area that will be important in the future.

MR. MILLER: It is a marvelous thing, to get a roomfull of actuaries sitting together in a situation where they think "ah-hah, we now have the opportunity to stretch our minds and come out with wonderful new waves of wrinkles and changes in product design". In term insurance, it won't work. There are an awful lot of product design changes that have been talked about, some of which have been recently introduced, that have the property of raising the initial cost of the coverage. Going from an ART to a level premium basis is one; the multi-year premium concept, which is the type of thing that is enormously appealing to actuaries, is another.

My own feeling is that universal life is going to largely take over, if it hasn't already, all of that middle ground that lies between pure, cheap term and "permanent insurance", or whatever that product is going to evolve into. I think universal life is going to, except in very specialized markets, eliminate the need for a lot of specially designed term coverage. One example is that an enormously popular sale in the New York Life, and I think a lot of peer companies, used to be a $10,000 whole life policy with say a $50,000 decreasing term, family income or mortgage protection rider. That sale doesn't exist anymore, because it is going to be a $50,000, $75,000 or $100,000 universal life sale. I would agree with those who say that select and ultimate does seem to be on the way out, and I hope that is true, and that is certainly healthy.

Otherwise, I guess I have a sort of contrary view and I think that term product development and product design, in response to marketplace pressures, is going to have to focus on what is the cheapest possible design under the circumstances. One thing I see in that direction, for example, is more unbundling of renewal and conversion features. Sure, you can have it, but at an extra cost and if you want a stripped down policy that is non-renewable, non-convertible, here it is.

MR. JONSKE: Relating to the distribution systems that we deal with, I would like to look at term insurance in two areas -- decreasing term and level term. While I will admit with Walt that decreasing term has, especially as a rider become less popular, it still represents a very big marketplace out there. This is especially true for companies like Allstate who market the product along with homeowners insurance. Interest in decreasing term plans may also be revived as a result of the introduction of banks into the insurance arena. With respect to decreasing term, the trends that continue to take place include:

- Introducing preferred classifications such as nonsmoker ratings.

- Providing increased flexibility in the schedule of insurance to cover the wide array of loans and the instability of interest rates with which we are confronted in today's economy.

- Introducing options which make the product more uniquely suited to cover a specific insurance need like mortgage protection insurance. This would encompass privileges which would grant mortgage protection insureds the ability to change or even increase their coverage in the event that a new mortgage was taken out on a new primary residence.

- Perhaps increased interest in joint life plans. In our increasing dual wage earner society, the need to provide insurance protection in the event of death of either life is apparent. Joint life mortgage protection can be especially popular for a multi-line distribution system.

- Simplified underwriting. This is especially true of anyone marketing decreasing term insurance through banks. A simplified application is almost mandatory.

Most interest in the product development of term insurance in recent years has been in the level term market. The activity might best be described as, "How low can you go?" Much of the activity has centered on how to obtain the lowest initial premium. Adverse persistency has led reinsurers and original writing companies to reevaluate select and ultimate pricing especially in concert with the choice of commission levels.

Current trends and future trends that may occur in term product development include:

- <u>Attained Age Indeterminate Premium Annual Renewable Term</u> -- This may be a viable product for companies which have not been active players in the select and ultimate term market. The ability to adjust premiums in future years allows the company to be somewhat more aggressive in pricing assumptions and thereby more competitive so that it is worthwhile even if the new valuation law does do a great deal to eliminate onerous deficiency reserves. Companies will need to be careful not to abuse this right because any attempt to make up for underpriced rates by increasing future rate scales too much will be subject to the anti-selection rate spiral that is one of the fatal flaws of the select and ultimate concept. One drawback often cited for attained age term rates is that rates which are able to support ultimate mortality at later ages are sometimes too high for new issues at those ages. This can be partly controlled by requiring expenses to be amortized over a relatively short time frame -- such as, 5 years or shorter, and having premiums beyond that point almost exclusively to covering mortality costs.

If there is still a problem for some companies who either have very low expense levels or high ultimate mortality expectations, another solution is to offer two plans -- one issued only at younger ages and a separate plan for the older ages. This does create an exposure to the select and ultimate syndrome at the crossover point, but if that point can be chosen so as to allow a gradual widening of the difference between the two scales, the risk can be spread. Also by having this crossover point chosen at the beginning stages of advancing age (say in the 40's), the adverse selection is less. Also, the plan for younger ages could have a more restricted renewal period than many of the plans currently offered to help control this as well.

. Offering Increasingly More Preferred Risk Classifications -- This includes, at the very least, a nonsmoker category, but can be expanded to include "good health" type discounts for people with "good health" characteristics. This can involve people engaged in active physical exercise programs and who exhibit desirable health maintenance. In offering these discounts, companies must become concerned about the validity of insureds qualifying for them. Repeated confirmation may become necessary. Some companies will undoubtedly experiment with physiological rating rather than our historical chronological rating system.

. Raise the Transaction Cost -- This can be done through various means like:

- Simply having the insured pay for underwriting costs. This can be done directly by having the client pay for his own medical exam or indirectly by an increased first-year policy fee.

- Introducing or Reintroducing Deposit Term -- This requires the consumer to provide an initial deposit up front to encourage persistency. Unfortunately, deposit term products have received some unfavorable publicity in the past. This resulted from products whose primary design objective was to pay a relatively high initial commission.

  However, the theory behind deposit term does make sense. One could almost argue that universal life is an outgrowth of deposit term. Most universal life policies have initial sales charges, that from a practical sense resemble a deposit term contract, sold with an annuity rider.

- Introducing Payment Modes Which are Larger Than 1 Year -- This could be thought to be like paying premium in advance. Again, nonforfeiture laws must be reviewed in conjunction with this proposal.

- Introducing Term Plans Which Have Limited Renewability -- I think Walt mentioned this a bit earlier. This could be done by having select and ultimate pricing, but where everyone must reenter after a period, such as 10 years.

- Introducing No Commission Products Which Are Based on Agents Charging "Fees for Service" -- Bill mentioned this. It would remove the incentive for agents to continually replace term products each year with a new carrier in order to receive first-year commission rates. Unfortunately, states' regulations and agent fears may inhibit movement in the direction of "fee for service" products.

- Developing Term Products -- Which combine universal life characteristics, such as in fund accumulation.

MR. MILLER: I think the audience was very well served by having Fred come after me, and his discussion indicates that almost certainly I was bit cavalier in almost dismissing a lot of specific designs, especially in the decreasing term area, and I would agree with him that, particularly if you are talking about non-agent distribution systems, there is some possibility for these designs. I even thought of a new one, while he was talking. Maybe we need some increasing amount term coverage in order to cover negative amortization under a variable rate mortgage, something that may exist in the marketplace before long.

MS. FAGERBERG: Several of you have commented on fee for service products, or level commissions. In the PPGA market, as it exists today, how feasible is such a product really? If anyone has experimented with these products I would like to hear about your experience.

MR. TYLER: Over the last year, Security Connecticut has made a couple of changes to their most popular select and ultimate product. They made one premium change, they increased premiums modestly at 5%, or somewhere in that ballpark, and simultaneously decreased the first year commission. That commission then was redistributed to years two through four. About six months after that change, they made a further change to reduce commissions, at least on the larger policies, to levelize commissions. In that case, in the larger policy market, the effect was to actually reduce the total compensation paid. Those were tough steps for them to take, and it has definitely had an impact on their sales this year. Their sales are down considerably, and they are very concerned about what the next step should be.

I think other companies that I am familiar with, who have been active in the term market, have made changes similar to Security Connecticut's. Generally, particularly in the very large policy market, there are enough companies who are still going with the product as it existed in 1983; therefore the company that is first to cut the commission rate or attempt to make a levelizing adjustment to the commissions, the sales basically disappear.

That is the problem. It is the bullet that has to be bitten by the company who has made the decision that the product is not properly priced and can't continue. If they have to step out in front, they are going to see reduced sales and deteriorating relationships with their distribution system.

MR. JONSKE: Fee for service still is a very new and novel approach, as most of you are aware, but it is something that is evident in the marketplace. I think LIMRA, in a study which they completed last year, said from 10% to 20% of all agents out there do charge fees. You will find that many agents who are charging fees, on top of the normal commission products, are not willing to cut their commissions immediately.

The other thing you will find is that the surge in that direction will also be somewhat impeded by states. There are a number of different state laws regarding fees for service. Not all states allow an agent to charge fees, and they run the gamut from some states stating that if you charge a fee, you cannot recieve a commission to others permitting the agent to receive both. If you charge a fee, you may have to be a licensed consultant. That is a problem. Also, if you don't have a separate company set up to handle "fee for service" business, you may find some states hesitant to permit you to have two products side-by-side, one that is fully loaded for commission, and another one that is discounted for the lack of commissions. This is because a few states disregard the difference in the allocation of distribution costs and perceive this as discrimination.

You will not see a surge in this direction, but I do think you will find that financial planners, especially financial planners who were not previously full-time insurance agents, will be the ones to break the ground in this arena.

MR. RICHARD W. KLING: My company has made a strong commitment to financial planning and financial planning for a fee. With this strategy we have obviously had to take a close look at our product lines and how they might fit the strategy. We recently had a couple of problems to deal with; in the term insurance area, one is the select and ultimate term or the graded premium whole life type product. With the lack of profitability in the product, and with the tax law changes and the reinsurers changing their deals, we could no longer offer them a going-in rate with a 55% commission, so we just threw the product out the first of October. We no longer offer it; we are not a major player either. We are at about $2 billion worth of term. But at the same time we did ask our distribution system, "What do you want, what do you need to meet your needs in the term insurance market?". Particularly in the larger case market, we ended up with a level commission product. The larger the size of the case, the lower the commission; it is a 10% level commission at $1,000,000 and up.

We don't know how well this is going to work yet, but people so far say, "Hey that looks great, we think we have what we want, and we have got a product out there as well", so we are just going to have to see how this goes at this point in time. We also stripped the product down completely, took out the renewability and the convertibility options, and all those things. So we made it just as much of a commodity product as we could. That is the general thrust that we intend now to go along with our fee planning concept.

MS. FAGERBERG: Now we will turn to monitoring experience. Certainly, the term war was fueled by the introduction of non-smoker discounts and select and ultimate products. There were many companies who entered the PPGA term market with no previous experience. While they were chasing volume and agents, agents were chasing compensation. The pricing assumptions got more and more aggressive, and now many people have large blocks of inforce business that just might explode on them. I would like our panelists to comment on how they monitored their inforce blocks, and also comment on the implications of indeterminate premiums; what would happen if one would raise premiums on an inforce block, and on the deferred acquisition asset questions, concerning these inforce blocks, where persistency and mortality might not be living up to expected. Also in this section, we can discuss preventing replacement, or the pros and cons of internal replacement.

MR. MILLER: I said to Denise yesterday that in a mutual company, deferred acquisition expense is the sum total of all the phone calls you get from your agents wondering why their commissions haven't been paid yet. I do not have a lot to contribute on monitoring experience. We do not have any evidence, at least yet, of unfavorable mortality. Our lapse rates have been lower, a good deal lower, than those reported in a lot of the horror stories that have been floating around, but they are still high enough to worry us a bit.

As Denise indicated, the big problem is the uncertain future. For example, the lapse experience on the business that we issued during the 15 odd golden months when we had the low rates, has been wonderful. Because of our perception of the effect of some of the transition provisions in the tax law, we felt we were able to continue those rates on 1984 anniversaries for those policies. But what is going to happen if/when we reach the decision -- to raise rates on these policies to something like what we would be charging then for currently issued policies? I can't contribute much except to say that it is an interesting dilemma.

I think rightly or wrongly, something that has motivated a lot of our planning and some of the programs that we have come out with has been a feeling that there is really not a good solution here. We are trying to find not the best alternative but the least bad alternative. We have had a feeling that, where we have a chance to do it, the least bad alternative often is the one that keeps the coverage with the New York Life, and we have done various things that way. On the other side, one nice thing about an indeterminate premium approach is that when things are getting better you have set up and publicized in advance and taught your agents about a mechanism that will adjust prices on inforce policies downward, if that is justified, when you cut them for new issues. I may be looking a good deal over the horizon as to whether we are ever going to get to that time looking at where we are now.

MR. TYLER: Obviously, as Denise indicated, being able to monitor the developing experience on an existing block of term business is extremely important. Judgements need to be made as to how the product is developing and what actions, if any, are available to correct the problem for the company's benefit in the future years on that block. My remarks here speak primarily to the Reinsurance Division in some of the activities that we have gone through to attempt to look at how our block of business is developing. We do look at our overall persistency experience on the block of business we have recently sold. Primarily this business has come to us as coinsurance and so we primarily are looking at our coinsured block of business and attempting to track that by duration as well as issue age and type of product. In addition, we are also interested in the type of company which produced the business for us to start with. Was it a company like New York Life that has basically a captive agency operation, or was it a brokerage term company like Security Connecticut, and so forth. You would see some pattern of difference obviously between those companies because those companies have differently designed products, but they also have different degrees of control over the quality of the business that was put on the books in the first place. It is very important that we look at all of the parameters and deal with each segment of the business as best we can, at least understanding what is happening to our results.

We also look at mortality in a similarly sophisticated way. Obviously, at the reinsurance level you have a great deal many more breakdowns that are of interest to you than you might have in the case of a direct company. The problem with the term business, is that the business is still very young, and we know the mortality assumptions that were built into the pricing of those programs were very aggressive and anticipated that there would be improvement in mortality over the long term. This essentially mirrored the kinds of assumptions that the primary companies were making, at the time the products were issued. The experience on this block of business is still not mature enough to be able to draw any conclusions about where mortality is leading. I think the general feeling is that the deterioration in the mortality on this block of business as the business continues to lapse or re-enter and so forth, is going to be a problem down the road.

One specific problem that Lincoln has as a reinsurer and I suspect most reinsurers have, is that a good deal of the business that they have received over the last few years has come to them on various forms of self-administration systems. It is very difficult to get the routine accounting reports and policy exhibit information from the clients for starters, much less the type of information needed to really assess the development of persistency and mortality on that block of business. I think this represents a key problem that we need to deal with, not only to understand what is happening on the block, but also for the more mundane purpose of simply putting our annual statement together.

One of the questions in the program had to do with the deferred acquisition cost (DAC). For the Reinsurance Division at Lincoln, at least ignoring the self-administered business which is dealt with on a separate basis, the deferred acquisition cost is developed from a model office of our inforce business and a factor approach is used. So what has happened to us in recent years as persistency has deteriorated on this block of term business, is that our GAAP commission rate has increased significantly as actual experience has deteriorated, versus what was expected in the valuation assumptions. So a good deal of write off of DAC has occurred, just as a natural consequence of the factor method as business drops off the books. In addition, we do occassionally add new blocks of business to this model, and this is done on a client company by client company basis, that is the sort of cell that we are looking at. As we have added companies to our model in recent years, we have been forced to establish valuation assumptions, for persistency in particular, that are more close to what the emerging results seem to be as opposed to the original pricing assumptions that were built into those programs. Obviously, as we have done that, the consequence has been that we have not been able to fully defer the initial acquisition cost on that block, and so in effect we have had some DAC write downs by virtue of the way that that model was established.

A question was raised about indeterminate premium programs. From a reinsurance point of view, while there are some variations from contract to contract, essentially, Lincoln as a reinsurer does not participate in any premium increase (or decrease, for that matter) that might occur on an existing block of business. Essentially, our programs are based on a net rate basis that is going to be guaranteed for the life of that contract, even though the client company may have the right to change the premium on inforce business in the future. That is not exclusively true, but that is by far the more common arrangement under our reinsurance programs today.

Finally, about 18 months ago, Lincoln introduced some rules in our underwriting department that were intended to place more focus on underwriting for persistency. We attempted to encourage our clients to consider similar approaches. One basic strategy that was employed there was to look at new applications, particularly large ones, and adjust the price that was quoted to the client in the event the policy represented the replacement of a prior coverage. Basically, the rules were if this policy has been replaced once within the last two years, or twice within the last five years, some sort of modified pricing was associated with the quotation that went to the client company. That program has worked satisfactorily from our standpoint, although "satisfactorily", I guess, would be defined as eliminating a lot of business coming to us that might otherwise have done so. We are, however, satisfied with that being the logical position, particularly on these large cases, where we often times are incurring additional acquisition cost to arrange the reinsurance in our favor, that is needed to totally cover the policy. We simply can't afford to take business if it is not going to have some prospects of staying in force for a reasonable period of time, and we have taken this action of looking at historic replacements patterns for that particular insured to use as a guide in underwriting.

MR. JONSKE: With respect to term insurance, you must monitor lapse rates, mortality assumptions and term conversion rates. Unfortunately, much of this experience takes many years to develop which you won't know at the time the policy is sold. There are other items which you must monitor and which develop trends immediately -- such as the issue-age range, the face amounts you are selling, the premium-payment modes, the issue placement ratio, underwriting classifications. You must determine how they differ from what you assumed in your pricing. For a smaller company, items as simple as the average face amount become important.

Although we at Lincoln Benefit have not had a reentry term product, we did have an attained-age ART policy back in 1980. At that point in time due to the severe strain we were under from deficiency reserves and with the reinsurance allowances that were given to us, we reduced our retention limits to zero and let the reinsurers have all the business. We thought we had a guaranteed profit which would equal or exceed what we thought we had in it. We were right. Since then, the scenario is much different. Reinsurance costs as a percent of premium, as we have seen, have gone up 8% to 10% of premium. With that type of increase, reinsured business becomes more of a marginal profit venture. The amount reinsured becomes important.

On the deferred acquisition asset situation, in the situations that I am familiar with, we really have had a problem since we have not been a major factor in the select and ultimate term market. We do use a factor process much like Bill mentioned, and to the extent we do see experience that is more adverse than what was expected, it would run off as those factors run off. To the extent that we did have some attained-age ART, at least in Lincoln Benefit, the experience was somewhat more adverse than we anticipated, but that represented less than 3% of our deferred acquisition costs. It was not a major factor. I do think when you are setting up GAAP reserve factors, you have to assume some contingency for adverse deviation. It is more important on term relative to the mortality assumption as opposed to permanent insurance, where you may have an investment risk that may be offsetting.

MR. JAMES W. PILGRIM: One comment, and one question. My comment is that our experience on the term business is that the accident hazard becomes a much more important factor in our mortality experience. The deaths as a result of accident, homicide, or suicide are much greater in our term business than natural deaths. That is probably a result of the fact that we have some excessive lapsation on our term business, and perhaps we were participating in cases where there was some speculation. However, the accident hazard has become a much more important factor, and I don't have the answers on how to underwrite that hazard adequately.

MR. MILLER: Jim, is that true even at older ages?

MR. PILGRIM: In our book of business, yes, the accident hazard is much more pronounced, and as a matter of fact the reinsured issue age is in the mid to high 40's. We have very little business in the 20's, and a modest amount in the 30's. So that is a real concern.

My question is both to Walt and Fred. When you talk about universal life being a way to sell lower cost coverage by virtue of the policyholder's paying the minimum premium to keep the policy in force, aren't we going to find down the road, and particularly for companies whose cost of insurance is a select and ultimate cost of insurance as opposed to an aggregate cost, that we might be experiencing some of the same things with universal life products that we have experienced on term insurance, that we really end up with a select and ultimate term product with a minimum premium? Have we installed systems to measure that, particularly relative to premium, and what are we going to do when we get there?

MR. MILLER: I hope that your question gets printed in bold-faced capitals when this session finally comes out in the Record. It is a very important point, and having been one of those who qualified for the naivete of the year award, already, I will just keep on that track and express the hope that most of us who are involved in pricing and repricing and designing universal life have learned our lesson about what happens when you get into the select and ultimate game for term pricing.

MR. JONSKE: I would concur with Walt. I hope that you might want to write your congressman or congresswoman and have that added to both the Democratic and Republican platforms at the next convention. I hope we shy away from the select and ultimate end of universal life; we certainly are not advocating that, at this point in time.

MR. BRIAN R. LAU: I would like to ask, to follow up a little further, if anybody has had any large claims in the first year on either cheap term or universal life. For a company our size, we have had a lot of problems with that, mostly in accidents, which is not unusual in our marketplace, but it is very surprising. I think some of the reinsurers might have been surprised at the claims fluctuation because I am beginning to think it is not usual.

MR. TYLER: I will more or less confirm what Jim Pilgrim said. I think for Lincoln's block of business, there has been an increase in the percentage of claims coming from violent deaths and accidents of various sorts. I have heard other reinsurers talk about having the same experience, so I think there is some general tendency in that direction. We have had a lot of early claims as well. In fact we first looked at some mortality results recently, and we thought we were seeing an awful lot of contestible claims coming up. Then when you look at the exposure you have, or at least that our book of business has, most of it is in those early years, because of the way the business has churned and because of sales growth in recent years, so really the proportion of claims in the early years is not unduely high; it is about what we would expect. But there is a tendency for there to be more violent deaths and accidents in the total claim record.

MR. PHILIP J. T. CERNANEC: I have a question in the form of a summary statement. Walt, you mentioned earlier that you hoped that we all become more rational over time. Could you in three or four points, mention what you think is more rational, with respect to the term products that we want to offer? With that, when are we going to get there, and how likely that is to occur?.

MR. MILLER: I think I probably speak for the panel, and hopefully for most of the audience, by offering the thought that perhaps the main aspect of "rationality" is recognition of what you can get into with select and ultimate pricing, and everything associated with that. The possible paths depend very much on whether select and ultimate stays with us, in which case there are strong pressures for other sorts of corrective actions like levelizing commission scales and so on. If select and ultimate doesn't stay with us, then maybe a number of these other things won't be necessary.

I can only repeat a personal opinion which may be very much a minority opinion that a lot of product design frills and gimmicks are not going to work out in the marketplace. Term is perceived as cheap coverage, and it had better stay cheap, or other people who can keep it cheap, even on a more rational basis, are going to sell most of it.

As to when these changes are going to occur, I have a very firm opinion in that there is no question that they are going to occur later than we all hope they will.

MR. JONSKE: Relative to the term phenomena we had, I think we had some artificial stimuli there, which perhaps won't be present on the universal life. For example, reinsurers created a climate which fostered some unsound product designs, which they are no longer doing. Second, I think companies were designing products thinking perhaps that they were getting some windfall tax benefits, which again, won't be the case now. In the absence of those stimuli, perhaps we won't play that game again.