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VOLUNTARY SALARY DEDUCTION PROGRAMS AND VOLUNTARY ASSOCIATION INSURANCE

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- o Group Universal Life:
  - Employer/employee programs
  - Association programs
- o Replacement of group term products
- o Administrative concerns
- o Captives and reinsurance

MR. DAVID B. MONTGOMERY: My name is David Montgomery. I am a Vice President of Tillinghast, and a member of our Chicago office staff.

Like myself, Mark Tullis is a Vice President of Tillinghast, and resides in our Atlanta office. Mark is quite knowledgeable about group payroll deduction Universal Life and will comment about this topic from the insurance company perspective.

Tom Coulter is Assistant Vice President and Actuary with Johnson and Higgins in New York. Tom is going to speak about both salary deduction programs and association insurance, from the employee/employer standpoint.

* Mr. Kenyon, not a member of the Society, is Second Vice President and National Marketing Director of Transamerica Assurance Company.

OPEN FORUM

Mr. Bruce Kenyon, Second Vice President and National Marketing Director of Transamerica Assurance Company, will give us an idea of the process which occurs in developing a program, and give us a list of critical concerns that must be addressed to make these products successful and viewed as an important employee benefit.

MR. MARK A. TULLIS: Since 1980, Universal Life insurance has attracted more attention and had a greater impact on the industry than any other product in life insurance history. Universal Life products originally used individual policy contracts. However, over the past few years most of the leading group carriers have developed Group Universal Life (GUL) products. Because of the sale of several spectacular GUL cases, this product has generated quite a bit of excitement within the industry.

Universal Life written through group policy forms has been used for a number of life insurance applications. One is the executive compensation market. Here we see specially-designed group universal forms used typically either with fixed premium payments or with limited premium flexibility; these are used in conjunction with programs of deferred compensation utilizing life insurance products. Such GUL products typically perform best in leveraged situations involving heavy policy loan activity, and individual certificates are owned by the employer rather than the employees.

A number of carriers use GUL plans to market programs involving sales of large amounts of individually-underwritten insurance to highly compensated individuals. Sometimes these plans involve tax advantaged employment arrangements. They may also be as simple as the plans of one major group writer to provide limited financial planning as a fringe benefit to executives of large corporations, using low-commission GUL products in conjunction with this planning. Typically, these certificates would be owned by the employee rather than the employer.

The market which has generated the most interest for GUL products, and which is potentially the largest GUL market, is the sale of the product on a mass-marketed basis, through salary deduction plans to large employers. One of the primary thrusts for GUL has been its use as a replacement vehicle for existing voluntary group term life plans. Indeed, several of the large cases where GUL has successfully been sold involve this group replacement approach.

A few of the carriers which have GUL products approved in at least one state are: Aetna, Connecticut General, The Equitable, Hartford, John Hancock, Metropolitan, New York Life, Prudential and Travelers. At least one of these companies actually has two GUL products approved: one which was designed and developed by its group marketing organization, and a separate product sold through its individual department to employer groups. The question of who markets GUL has been one that a number of these companies have had to address, particularly since many companies currently have some department other than the group department marketing individual salary savings products. One of the internal political questions to be addressed is: will the GUL product be marketed through this area, or through the group department?

For years companies have used individual life insurance, and even individual Universal Life insurance products in the salary deduction market. What advantages are there to the GUL concept?

The first is increased flexibility. Differing compensation needs, competitive pressures, and the desirability of varying mortality charges between groups make it impossible for one generic product to serve the marketplace addressed by GUL. Many states prohibit a company from filing an individual policy form and later changing these factors for different market situations. Different product filings would be required for each variation. This is still a problem to some extent with GUL. However, it is possible in a majority of states to file a generic group contract and change the expense loadings on a group by group basis, similarly to what has been done for years in the group term market.

A number of carriers have also been experimenting with market value adjustments and other penalties upon termination of the master group contract, both of which may be found in group contracts and are not currently permissible for individual policies.

Use of a Multiple Employer Trust, or MET, and the filing of the group product in the state where the trust is located results in a product which may be sold in over 30 states without additional filings in those states, if the product is used only in genuine employee/employer situations. Although the remaining states impose varying levels of additional requirements, the filing process is generally simpler than for a similar individual product, especially when genuine employer groups are involved.

This is particularly important because the larger GUL cases are typically subject to quite a bit of negotiation and variation on a group by group basis. Finally, there may be some marketing advantages to the group over the individual approach. Group Universal Life has become a fairly hot topic. Some of its typical features, such as experience rating, mortality charges based upon actual group experience, and group underwriting techniques may have marketing appeal. Also, because many of the plans are designed to look like voluntary group term life, they can be expressed in terms that are familiar to the employer. Together, these reasons point to continuing growth in the use of GUL to serve the payroll deduction market, and particularly the large employer segment of this market.

There are a number of common misconceptions about GUL. The first misconception is: Enrollment technique is less important for GUL than for individual salary savings products. Of course, with any payroll deduction sale there are really two sales: the master sale to the employer, and the enrollment of individual employees. Enrollment of a high percentage of employees is the key toward keeping down mortality costs and making these plans work. Companies have found that a good deal of planning is needed in developing appropriate enrollment strategy.

Another misconception is: GUL results in better mortality than individual products sold in the same market. Our examination of insurance rates quoted in a number of these cases would indicate that much more optimistic mortality assumptions are being used for some GUL cases than for similarly priced individual products. It's important to remember that, for a given sized group, a given enrollment level, and a given set of underwriting standards, it's irrelevant whether the product is written under a group or an individual form. The mortality is going to be the same in either case.

A third misconception is: GUL is cheaper to administer than individual Universal Life sold in the salary savings market. A number of companies offering GUL have developed a product within their group departments which, of course, are used to thinking of expenses in group terms. However, if you plan to offer true Group Universal Life, including the cash value accumulation feature, it's necessary to do the policy accounting and reporting in virtually the same manner as with individual products. A number of companies have found that this type of product is much more expensive to administer than typical group plans.

These misconceptions can be summed up by noting that real differences will exist between group and individual products only to the extent that the plans are designed differently. It's true that the GUL market as it currently exists is extremely competitive, and there's no room for excessive expense loads and overhead allocations. However, actual differences in the GUL product will only exist to the extent that it is truly designed differently.

Let's touch briefly on some of the product design considerations of GUL. First of all, GUL products are commissioned more like traditional group products than are typical of individual payroll-deduction Universal Life products. Instead of basing commissions on a fairly high percentage of some sort of target premium, as in the individual policies, GUL products pay commissions based on the cost of insurance rates using more typical group scales. An important point is: It is necessary for companies to be flexible with respect to commissions, particularly for the large cases.

When the first individual Universal Life products came out, everybody talked about how the product has been unbundled. That is, how the different cost components, such as expense loads and mortality charges, stood on their own. However, it didn't take long before the industry managed to hide its high commissions and expenses, and bundle the product up just like a traditional plan. With Group Universal Life it's *very important* for the company to take a truly unbundled posture, particularly in situations where the company will not have control over enrollment. We've seen a number of situations where plans have been designed with "loss leader" mortality rates, where the company expected to make up the difference in its asset spread only to find that the plan was enrolled virtually on a pure term basis, and it was stuck with those loss leader insurance rates.

Relative to individual products used in payroll deduction, it's more important than ever to be "group responsive". With the large size cases that are being quoted on, it's necessary for the company to carefully examine the characteristics of the group and tailor the quote to that specific group, much as is done in the group term life area. If you allow your field force to quote a "canned, middle-of-the road" GUL product, you'll find that you end up with those groups that nobody else wants.

Finally, GUL underwriting is more similar to traditional voluntary group term life than to individual salary deduction plans. Carriers generally attempt to get existing experience history for the group when quoting proposed cost of insurance rates. For the most part, cost of insurance rates are then experience-rated on a group basis, or else altered prospectively based on actual experience of the group. Limits for guaranteed issues, simplified issue, etc., tend to be based on group concepts. Incidentally, rules used by carriers are on the whole more liberal than those used for voluntary group term simply because of competitive pressures in the marketplace.

There are some technical issues that have to be addressed by any carrier considering this market:

The Universal Life model regulation adopted by the NAIC, which addresses valuation for individual products, is specifically inapplicable to group plans, although the regulation reads that "states are free to adopt whatever portions of this regulation are appropriate for group insurance and are in accordance with state law." The most crucial valuation question concerns a common situation with this product, where cost of insurance rates are guaranteed at current levels for three to five years and current interest rates may be guaranteed for a period of time. It is possible that reserves may be required to take these guarantees into account, although short-term rate guarantees have traditionally been made in the group business and have *not* generally been reserved for, as long as they are set at a basis which is expected to make a profit.

Another question involves which set of guaranteed cost of insurance rates to include in the master contract. In addition to possible valuation considerations, there are also non-forfeiture implications, particularly in states which require group contracts to meet requirements for individual policy forms. Offsetting this, companies need high cost of insurance rates, as the rates have to be adequate to support expected mortality experience for different types of groups, and for situations with varying expense requirements. We are aware of companies with GUL products using guaranteed COI rates based upon 1958 CSO, 1980 CSO Male, Unisex 1980 CSO, and 1960 CSG rates.

Generally, the Standard Non-forfeiture Law is not applicable to group insurance. However, a number of states may require that GUL products meet individual policy requirements, and a number of companies have filed these products with traditional actuarial demonstrations to show compliance with the Standard Non-forfeiture Law.

An issue to be addressed by a carrier looking at this market is the extent to and the mechanism by which portability will be granted to individual employee certificate holders. How will employees who leave the group be entitled to maintain their coverage in force? Carriers differ as to their practices in this area, with some carriers recommending non-portability of plans, whereby employees terminating employment would be required to surrender their certificates. On the other hand, some carriers define the group to include terminated and continuing employees.

New York's recently enacted group law places new requirements on companies which, in the past, have sold products in New York through the use of out-of-state METs. The new law is applicable even in situations where the master contract holder is outside the state of New York, if the certificate is delivered in the state. Furthermore, a proposed law may be introduced in this session of the New York legislature that would require Group Universal Life products to comply with New York's requirements for individual Universal Life contracts.

One of the disadvantages of the group form, relative to individual policies, is the possibility of imputing income to the certificate holder through the Section 79 regulations. Situations can arise where an income tax could be imputed to the certificate holder which exceeds the premium he has paid for his (employee pay all) certificate. Clearly, for any GUL plan to succeed, it is essential that it be immune from Section 79. A number of methods have been used to make sure these plans do not fall within Section 79, and any carrier which is investigating this market must address this issue.

GUL is not for all companies. Certain regulatory and filing advantages can be obtained by selling small case salary savings products through the GUL policy form. However, the large case market, with its experience rating and case-by-case quotes really points toward the need for the more flexible group approach. GUL's importance should continue to grow in the years ahead, and the product will become necessary in the portfolio of any company marketing in the group arena. One of the primary motivations for companies to develop GUL products is really a defensive one -- that of protecting their existing voluntary group term life business, as well as their primary group coverage.

I expect that, in the future, the minimum case size for true GUL products will decrease from the jumbo to the middle-sized salary savings case, and that pooling techniques will be applied to smaller cases where there is not sufficient credibility to experience rate on a group by group basis. It has been estimated that between 10% and 30% of major corporations will adopt a group universal product within the next few years. Regardless of the figure, we have heard from a number of people marketing this product that virtually all of the large-size payroll deduction cases in the future will be written on GUL plans.

MR. THOMAS G. COULTER: Group Universal Life combines the best parts of two different products. Group term insurance, offered on a voluntary basis to employees or members of professional associations, has been around for a long time. Universal Life is a relatively new product which has become immensely popular. Group Universal Life (GUL) is a voluntary-term insurance program which incorporates flexible premiums and benefits with the ability to accumulate cash values at current interest rates. A successful Group Universal Life Program must meet employees' needs and desires.

The greatest need is for reasonably priced term insurance, available to all, or almost all employees. A substantial amount of insurance, available on a guaranteed-issue basis, is essential both administratively and to ensure high participation. It is better to replace existing voluntary and/or basic term programs with GUL, since the promise of substantial participation will make negotiating guaranteed issue limits easier.

Reasonably priced term insurance means no increase, or possibly a decrease in what the employee is paying under any existing programs. The cost of insurance rates charged under GUL will vary by attained age, while many existing term plans charge a single socialized rate. The new rates will obviously be attractive to younger employees, who will pay less. Older employees will not necessarily pay more. This is because elimination of both (a) Section 79 imputed income; and (b) any subsidy of other benefit programs made with excess life premium, may make the after-tax difference in cost negligible for many participants.

GUL is meant to be portable, whereby the employee can continue coverage either (a) at termination of employment; or (b) at retirement. Premiums are then continued on a direct-pay basis. When written under a group contract, carriers are also allowing for continuation, or conversion to a nearly identical individual contract should the group policy terminate. In fact, some states require this provision before regulatory approval is granted.

The opportunity to make planned premium payments greater than the current cost of term insurance, and the ability to make unscheduled premium payments has appeal to all employees.

Many contracts contain a paid-up benefit. While the form of this benefit varies greatly, the idea is to allow the employee to stop paying premium at retirement, but to continue at least some coverage for life. The most popular provisions provide for an adjustable death benefit which depends on future assumptions of mortality, interest and expenses.

There can be many other variations in plan design. A sophisticated policy design involving fixed premium GUL would allow participants to qualify their coverage under Section 264 of the Internal Revenue Code. This design would appeal mostly to the highly-compensated employees of the firm. Offering a choice between a fixed premium and a flexible premium product might prove the most popular combination.

Employees will be attracted by a competitive interest rate. In my opinion, competitive does not necessarily mean competitive with what other Universal Life policies are paying, but probably with what other common financial instruments, such as 12-month CDs, offer. A competitive rate would be, for example, 100 basis points above these short-term rates. I also think GUL will eventually offer a variety of fixed income, equity, bond and possibly even real estate investment options.

Employers are motivated to offer GUL for several reasons. GUL represents a state-of-the-art employee benefit. It can also be a highly visible benefit, used to motivate existing employees and attract new employees.

GUL programs are one solution to non-contributory Section 79 life plans which offer discriminatory benefits. The alternative is either decreasing coverage on highly compensated individuals, or paying the extra cost of bringing all other employees up to the highest level of coverage. By offering all employees the same choices, the plan is no longer discriminatory. Another reason for the popularity of GUL is: it gives the individual employee the ability to choose insurance to meet his individual needs.

Employers' concerns about the cost of post-retirement coverage has been another motivation. The Statement of Financial Accounting Standards No. 81, "Disclosure of Post-Retirement Health Care and Life Insurance Benefits," requires employers to disclose the cost of providing post-retirement life insurance benefits. If a company accrues the future cost of these benefits over the active worklife of its employees, the effect on current earnings can be substantial. Employers may wish to consider cutting back on these benefits while they still can. Recent court decisions limit the employer's ability to rescind its promise to retired employees and to those near retirement. Legislation has also been introduced in Congress to accomplish this.

Employers are reluctant to include this benefit in Section 125 plans, offering it instead outside of the 125 plan. All life insurance purchased inside the 125 plan will be subject to Section 79 treatment. In many situations, I have seen tax on the imputed income exceed the tax saved by purchasing insurance with pre-tax dollars.

Because these programs may be exempt from Section 79 treatment, employers are motivated to place as much insurance as possible outside their employer-paid programs. A typical technique is to reduce all employer-provided coverage to the lesser of one times earnings or $50,000.

Sometimes GUL is offered on top of already generous basic and voluntary term programs. Typically, such programs will have poor participation and will be unable to operate efficiently.

True GUL is enrolled like other benefit programs. One-on-one sales techniques are usually not necessary to achieve high awareness and participation. Rather, a program communicated as a replacement for existing life programs will already have good participation by rolling over participants from the other programs. New programs may typically have lower participation on the first enrollment, but good results can nonetheless be obtained.

Before agreeing to allow a GUL plan, the employer will want to consider the impact on other benefit programs. A GUL enrollment which sells the cash accumulation aspect too aggressively might drain away dollars from 401(k) or thrift plans.

On the other hand, a GUL plan might provide an attractive alternative for any employee forced to discontinue contributions to retirement plans, should Congress act to limit contributions, or should the plan not meet discrimination rules.

Administration is a critical issue. While many large employers currently self-administer their voluntary term programs, they will be unable to do all the recordkeeping, process surrenders or loans, or provide illustrations or annual reports to participants. Ultimate acceptance by employees and the goodwill created will depend greatly on administration.

There are many similarities between GUL marketed to professional associations and GUL marketed to employer groups. The sponsoring association, desires to make available to its members a valuable benefit, thereby strengthening the members' affiliation to the group, and attracting new members as well. For some associations, GUL may provide an additional source of income to defray expenses.

Many associations consider term insurance to be a right of continued membership. This is inconsistent with GUL, which is a form of permanent insurance, and some provision for continuation of coverage must be made.

A successful GUL program for associations will have much the same design as employee programs. There are some important differences, however.

Enrolling GUL for associations is more difficult, in my opinion. It really helps if the association's term program is rolled over into group GUL. Reasonable participation is then assured, and the acquisition costs will be spread out. The audience is financially sophisticated and generally affluent. The competition for insurance dollars is also likely to be keener. Direct competition with UL policies sold by traditional means is apparent. It is important to be able to illustrate different scenarios to meet individual needs.

Because of the limited participation in even the most successful association programs, guaranteed-issue will not be available, except on existing amounts rolled over from term programs.

I think efforts to sell the cash-accumulation aspects of the program will be most successful in the professional association marketplace, due to the general sophistication of the group. On the other hand, this awareness may possibly lead to greater policy loans and withdrawal activity.

VOLUNTARY SALARY DEDUCTION PROGRAMS

MR. K. BRUCE KENYON: Transamerica Assurance Company is the mass-marketing specialist company of the Transamerica Life Companies, and I'd like to give you an idea of the thought process that took place when our corporation was examining the possibility of entering the mass-marketing arena.

The fundamental question which must be addressed in entering the payroll savings market is corporate commitment. Does the parent carrier really intend to make a major move into the market, or are they just "hopping on the band-wagon" because they don't want to miss out on sales opportunities? Many companies miss the crux of the issue entirely. They fail to recognize that payroll deduction marketing is a truly different type of program. The requirements for valuation, marketing, sales, training, and administration are very different from those used in their individual or group operations. If the company wishes to offer a product and does not wish to dedicate a substantial share of assets to the program, this fact should be taken into account in all phases of development. Will the payroll deduction program be administered from a separate department, or a division of advanced sales, or will it be another product offered by the ordinary line? This is an important issue which will affect virtually all other aspects of the operation.

The situation with Transamerica Assurance Company is a carte-blanche scenario where the corporation will be providing all necessary assets and support to create a complete mass-marketing company. Given strong corporate backing, we can begin with the process of designing a competitive, viable payroll deduction program.

The macro-market of available sales prospects has certainly been well-defined by now. A favorite LIMRA study figure we find quoted repeatedly is: 85% of the American public is ignored by the majority of insurance sales persons. The revenue to be realized by small-policy individual sales is not sufficient to support the process of solicitation. The cost of travel, sales presentation, and policy delivery are just too high.

Looking at it from a different perspective, the payroll deduction market is comprised of over 108 million American workers -- 60% of whom profess to have no personal insurance agent, and 50% of whom do not even maintain a checking account. This last figure alone could stop the normal sales process from being completed, with no means of drawing off the deposited funds. Getting a flow of premium payments into effect would be virtually impossible. That leaves payroll deduction. Further studies show that over 75% of all U.S. workers have little or no group insurance. That leaves an enormous number of people who would be well served by a self-paid plan administered at their place of business.

The overall market is primarily a factor only in making the decision of whether or not the company wishes to enter the market at all. It's essential now to define the target market for the specific program to be developed. The term "mass marketing" is loosely bandied about, as if it had a concrete definition, which it doesn't, and as if the listener knew exactly to what it was referring to, which he doesn't.

By the same token, the term "payroll deduction" has many possible applications. It is important to define the terms which will be used, and the markets to which they will be applied. The standard application of the term "payroll deduction" involves the employer/employee related sale, in which the presentation is made on company time and premiums are deducted from the weekly payroll. However, different profit assumptions must be made, depending on variations of this marketing theme.

It's not really possible to design a program which is front-line competitive in all size ranges. Therefore, when designing the program, the size of the target company is important. If you decide to go after a large case market, what will the minimum size be -- 500 lives, 1,000 lives, 10,000 lives? Will you offer a banded product, which is more advantageous as the size of the company increases? There are a limited number of jumbo cases, and just as there is fierce competition for the larger individual policies, there is equal competition for the IBMs and Chryslers of the world. In fact, over 95% of American businesses employ less than 100 people. If this small case market is to be targeted, further definition is required. How small is small? What's the minimum number of lives to be solicited -- five lives, ten, fifty? This will have a substantial effect on the underwriting procedures used.

Or, perhaps you wish to depart from the pure employer/employee market. There is currently a great deal of interest in providing insurance plans for association groups. A decision to get into this market could be profitable, but obviously, the standard individual interview format cannot be used in this case. The type of group to be solicited is also a factor. A plan which is designed to appeal to white collar workers may be unusable for blue collar industries, or vice-versa.

Once we define our market, it is essential to know how and by whom the product will be sold, and to help acclimate the sales force to the product and sales techniques inherent to payroll savings. Non-captive general agencies may require different types of incentives, such as convention credits and production bonuses, for high-volume sales. Brokerage business requires both product competitiveness and high compensation. Because brokers are not bound to a particular product, it is not enough to rely on company loyalty or familiarity as a sales incentive. If you have a mix of different types of distributors, as many companies have, the problem is more complicated. Again, you'll need a specific path to proceed down, or to choose a middle ground, realizing the ultimate effect on sales your decision will bring.

Of course, no company operates in a vacuum. While there were a limited number of entities in the payroll deduction field just five or six years ago, suddenly everyone wants a "piece of the action." You'll need to know what's on the street to keep your own program state-of-the-art. We've seen a number of programs which have been set up as loss leaders to control additional employee benefit programs for their large clients, which have historically been high premium producers. This is an approach -- but is it a long-term or a losing proposition? Eventually the claims are going to have to be paid, and no chief executive officer is going to continue to swallow a nonprofitable business. Regardless of the competition, the mass marketing book of business must stand on its own feet profitwise.

Within the constraints of profitability, there are many areas where a competitive edge may be established. The trick is to identify the "hot button," especially for employers and personnel managers. This is particularly true, again, in the large case market where a client is most likely to be out for bid. Without a doubt, the face amount of insurance per dollar spent is the primary measure of a plan's competitiveness. However, providing a huge death benefit at the expense of significant nonforfeiture values can backfire. Underwriting is a primary concern, but the large case market is rapidly getting to the point where a non-guaranteed-issue program will not even be considered. Even with smaller cases, employers must install plans that *all* employees can take advantage of. The trick is to find a balance in your program which offers a sufficient degree of guaranteed acceptance, and still provides substantial insurance benefits that are perceived as special by the work force and the employer.

This brings us to the design of the product itself. Most of the earlier payroll deduction programs were written using low interest, whole life products, which at the time were considered quite competitive. The recent term explosion and introduction of Universal Life has had the same effect on the salary savings business that it has had upon individual sales. Group Universal Life plans are a new entry in the race, and are already receiving a lot of attention. Once again, it's primarily the large case market in which product comparisons are likely to be critical. Smaller businesses are still relatively virgin territory and are not as likely to shop around before making a decision. However, Universal Life seems to have made a real beachhead in the market and, when a specific product is requested, it usually is some form of interest-sensitive product.

One way to get around the "which product should we offer" dilemma, is: Devise a combination plan which offers a basic Universal Life product plus various rider coverages that make the entire program more attractive. By all means, make sure that your product development team includes a good "state filing and compliance" person. State regulations have become more and more onerous, especially regarding interest-sensitive products. What is permissible in one state may cause absolute rejection in another. It would probably be impossible to design an interest-sensitive product that met the requirements of all 50 states. And, even if it were possible, the end result would be so non-competitive it would blow you out of the market. You also cannot afford to develop a special product for each and every state. The resulting administrative nightmare will cause your program to sink very quickly under its own weight. The product should be designed to meet the major requirements of the majority of states, with a minimum number of variations for states with similar requirements. Obviously, the simpler the product, the less likely the compliance problem. But simplicity must be balanced with competitiveness. Although the product and program are not synonymous, by using a broad-brush approach to product design you may be able to lessen the state approval problem. Profitability and competitiveness concerns may then be addressed by properly structuring the underwriting and eligibility requirements.

It would be a toss-up to decide whether underwriting should fall under program or product design because of the extreme importance of each area. The effect of mortality on the pricing of the product can't be ignored when designing the program. Nor can the exigencies of the market be ignored. Guaranteed issue is a virtual requirement in larger cases. But, by the same token, larger cases which are enrolled in the desired manner provide a spread of risk which alleviates the mortality concern somewhat. For our purposes, we will consider guaranteed issue to be a given factor for large cases. As cases get smaller, variations on guaranteed issue can be considered, such as guaranteed acceptance, simplified issue, accept/reject, and so forth.

Once you leave the realm of simplified issue, you really leave the concept of mass marketing as well. Fully-underwritten programs are not generally applicable in a payroll deduction program. However, given that very liberal policy underwriting is the rule, there are a number of ways to mitigate the effects. Case underwriting, where a case is submitted for approval prior to solicitation, can protect a company from writing highly hazardous businesses, or those whose turnover would result in an unacceptable persistency. Even under a guaranteed-issue plan, eligibility rules may be established to provide a certain level of protection. Most programs, even straight guaranteed-issue plans, require an actively-at-work status, or a not-currently-hospitalized restriction. These restrictions require a high level of confidence in the ability and intent of the field agents to follow the guidelines which are set up. It is highly suggested that the claims be maintained in agency cross-reference files to identify agents who do not follow the established underwriting guidelines. Repeat offenders may not be approved for guaranteed issue cases, or may be restricted from writing business under the program at all.

Two concepts, which I call "The Golden Rules of Payroll Deduction," are the nearest things to absolutes which we have found throughout the industry in designing payroll deduction plans. They provide some extremely fundamental pricing factors:

1) A centralized billing facility. The savings created by this billing policy figures strongly in the pricing equation and is essential to the plan. Billing does not necessarily have to be specifically a payroll deduction feature. A credit union or other bank account is just as feasible as a payroll billing feature, as long as the carrier may provide a single list to the billing authority.

2) Perhaps more importantly, the employer must agree to a mandatory individual interview, on site and on company time. Setting up in the cafeteria and expecting employees to give up their lunch hour to talk to an insurance agent is pure folly. The same is true of voluntary interviews before or after work, on or during coffee breaks. These approaches plainly and simply do not provide sufficient penetration to allow simplified underwriting, and therefore will prevent a program from becoming a success. I have yet to meet an agent who wasn't sure that his or her case would be different, but history is so fraught with similar failures that such claims are invalid. Difficult as it may be, we tell our field representatives that if they're unable to persuade the employer to grant mandatory interviews it is best to walk away from the case.

One way to make your program stand apart from the crowd is with the availability of companion programs and additional coverage riders. Will spouse coverage on an individual basis be offered? Must the employee also participate to get spouse coverage? What underwriting should be accorded? These questions must be considered in the same light as the original employee program. Children may be covered either through individual policies, or by means of a term rider. Other riders, which may be required depending on the specific market being pursued, include accidental indemnity, waiver of premium, transfer of insureds, and family term riders. Each addition may remove a possible objection by a specific employer, but the need for simplicity should also not be ignored. A properly designed program should allow for a very speedy enrollment interview.

The more options involved, the longer the interview, and the greater the chance of confusing the employee. Set up your program and file the riders, but restrict their availability to those programs which require them.

On commissions: the best methods of payment are as arguable as the number of agents involved in the discussion. I have had general agents inform me that it was impossible for them to survive with a 20% override on business in which they had no direct sales involvement. By the same token, a number of large brokerage houses prefer a flat commission schedule with level payments over a period of years. The decision, on a schedule which is incorporated into the pricing formula will depend on the distribution system employed by the carrier. Obviously, the higher the compensation the more attractive it will be to the salesperson. Some companies thrive on the unswerving loyalty of a highly commissioned sales force which does not broker business at all. Others depend on their competitive rates to produce such a high volume of business that a lower commission rate is acceptable. Which direction the company chooses is an internal decision, and a vital one.

Once the product and program have been decided upon, proper steps toward implementation are essential. All issue and administrative systems should be in place, up-and-running in a reliable manner prior to announcing the plan. There is nothing that will strain your credibility more than announcing a program which cannot be issued, underwritten, billed, or off which commissions cannot be paid in a timely manner. You'd be amazed at how many times this happens. Cohesive sales materials that have a finished, unified look should be available prior to starting sales. This includes preannouncement letters, employer and employee presentations, slides and/or video materials. This sounds like it should be an "of course they should be ready" item, but frequently that is not the case.

Advertising -- the greatest program in the world is useless without proper publicity, in the form of announcements to the field force and through trade journal advertising. The last thing a marketing director ever wants to hear at a sales meeting, a year after the product is introduced, is "I didn't know we have a program like that" after he has just finished a presentation of his proud creation. These comments usually come from the same people who got at least 13 field service bulletins announcing the product.

Training -- part of any new program is a companion training and sales assistance program to introduce and familiarize your sales force with the plan. There is a prevailing mind-set with many companies' senior management that there is an enormous block of business waiting to roll through the door as soon as the payroll deduction plan is unveiled. The block is there, but it's not going to roll anywhere unless you push it. Most agents have a comfort level with their current sales technique, whether they're selling pension plans, deferred compensation, or cancer insurance. There is a natural hesitation to enter a new field, regardless of how often you reassure them of how easy it is, make sales calls with them, provide training sessions for their personnel, praise noteworthy accomplishments in the program, and are available 24 hours a day. The difficulty of getting a new program up-and-running should not be underestimated, but the end result is more than worth the effort.

For those of you who are called upon to work with a payroll deduction program, congratulations! You will find yourself at the forefront of the insurance programs of the future, and your companies will be positioned to survive the next business pruning cycle.

MR. PETER B. HUTZEL: I heard a couple of comments on the adverse mortality under some of the aggressively-marketed GUL programs. Is that based on any experience to date?

MR. TULLIS: I didn't mean to make a comment about adverse mortality. What I really meant to say was, if you compare the cost of insurance rates, and you compare the assumption that must have been made in order to make these profitable, and then you compare this with what we see being used for individual salary savings products, somebody is using a lot lower assumption for their group product. My comment wasn't really related to any kind of experience. In my opinion, people are being a lot more aggressive in their pricing on the mortality for group plans than for individual plans. I feel that's not justified unless you have some reason to believe that group plans have better mortality than the individual plans.

MS. JEANNE M. STAMANT: Does anybody have an idea what the expected persistency on this business is likely to be, relative to individual Universal Life? In particular, how is the employee turnover evaluated in determining a persistency assumption for the business?

MR. KENYON: With our specific product, we try to institute a six-month wait as a qualification period for the employee, recognizing the fact that there is going to be a high turnover of newly-hired employees. We hope to take care of the majority of that afterwards. We do know that there will be some adverse effect on the persistency caused by termination. You definitely want to have an aggressive follow-up program whereby, when someone leaves the program for any reason, whether they're fired, whether they quit, their spouse moves, whatever, that they are aggressively pursued and given the opportunity to continue their program on a direct-bill basis.

MR. TED L. DUNN: How much of this product is currently being sold in the marketplace today?

MR. COULTER: I can speak for J&H. We're currently the broker of record for plans involving about 1/2 million people. I think there's more in the works, too.

MR. TULLIS: Let me make a comment to keep that in perspective. J&H has been extremely active, so don't assume you can take the 1/2 million and multiply by some big factor to represent other sales. J&H has been one of the major players in this market.

MR. GEORGE F. M. MAYO: I'd like to address a question on the subject of employee disclosure, because Universal Life is an awfully difficult product to compare, depending on how you calculate your fixed premiums and what rate of interest you assume. You may get two apparently competing products, one of which shows a much bigger sum insured for the same premium as another one, but with a much lower cash value accumulation. How is the poor employee to determine between the two products, and what sort of disclosure is made to help him in making that choice?

MR. TULLIS: The employee is not really given any choice between two products. The choice is made at the employer level. He has to assume that a certain amount of due diligence has gone by his employer, and that's one of the reasons why the plans work as well as they do. The employer may have had several different options made to him. The real crux of the matter is that the employee voluntarily participates. There is no requirement. It's not like the employer has selected a program that everybody has to get into. As long as there is an option on the employee's part to get into or out of the program, I think you can avoid that. But, they should be told what the interest rate assumptions are for any projections given. I think, certainly, computer printouts are very clear in that regard.

MR. MICHAEL D. SYDLASKE: How easy is it for an employer to change carriers with Universal Life plans?

MR. TULLIS: It's very difficult. First of all, the whole concept is so new that we can't talk about 500 actual cases where it's been changed, but in discussions with carriers, one of the advantages we talked about is that it would be difficult to change carriers.

MR. COULTER: In my discussion with employers, one advantage is that it's *easy* to change carriers. There are a couple of questions. One is, "Who owns the records and can they be transferred?" And, the second one is, "How do you roll over those cash values?" Are there surrender charges? Will the carrier demand some type of market value adjustment, if you roll over the entire group?" As to who owns the records, I would strongly urge the employer to maintain that *he* owns the records and to have that spelled out in the agreement. I think the issue of rolling over a block of cash values which may be invested in long-term securities is a valid one, and you'd have to consider what kind of reasonable adjustment you might make.

MR. TULLIS: One consideration would be whether there is some kind of guarantee given, for an intermediate period of time. Another consideration would be, (even though Tom maintains it's easy, and certainly it would be easy compared to individual policy contracts) that it's still more complicated than replacing a voluntary group term life plan. You do have some complications that you have to deal with.

MR. KENYON: Plus, many plans are sold on an individual plan basis, and replacing one of those can be very difficult because the employee has the right to continue coverage on his own, whether the employer continues the payroll deduction or not. He can do it on a direct-bill basis.

MR. J. MARTIN DICKLER: I have a question on group Universal Life. Is there any data available as to what extent employees are putting money into these plans, over and above what they have to put in for the group term part? I understand that there is a lot of flexibility, and that employees can put a lot or a little on a payroll deduction basis into it. Of all employees who enroll in a GUL plan, what would your forecast be of the percentage who would contribute over and above?

MR. COULTER: I can't give a general rule. I think it depends on how the plan is communicated to the employees. In some situations employers have been afraid that the GUL will cannibalize their 401(k) or their savings and investment plans. They wanted the communication materials to be toned down accordingly. But, in other situations, the employer thinks this is a great idea and when the communication materials reflects that, you get a much higher cash value contribution. It also depends on the general affluence of the group.

MR. MARC PREMINGER: Mr. Tullis, what alternative contract termination clauses/provisions have you seen dealing with the disintermediation risk? Are the employers prepared to assume payment of the market value charge if there are market value charges in the contract?

MR. TULLIS: Everything is negotiable. I know one carrier that has market value adjustments. There are separate market value adjustments for group termination and for individual terminations. And, I know that they have done some business with J&H where that provision has been stricken for a particular case. So, it's negotiable, but that's what the carrier is trying to get away with. I know of a carrier reserving the right to make the payments over a period of time, in the case of a group termination. Instead of immediately coughing up all of the cash value if there is a group termination, they would have the right to pay the cash values out over a period of three to five years.

MR. PREMINGER: Would the insurance remain in force for those people?

MR. TULLIS: No.

MR. PREMINGER: Well, then do you have a tax problem there?

MR. TULLIS: I don't really know.

MR. PREMINGER: Has there been a lot of awareness of, or discussion of this, either by brokers or employers? When you say that it's easy to cancel this contract, they should be aware of what the consequences would be.

MR. TULLIS: You mean if there is a market value adjustment of the contract?

MR. PREMINGER: A market value adjustment, or a reduction in the interest credited, or a spread payout formula, or other consequences, if the insurance carrier is taking that disintermediation risk?

MR. TULLIS: Absolutely, if there is such a provision, the employee has to be aware of it. But they're generally aware of those provisions because they are in their GIC contracts. The question of how the employees get whole, since it is employee money, obviously hasn't come up because no one has done this yet. I think the feeling among the employers is that this is a permanent benefit and there is generally no reason to move a case.