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NEW DEVELOPMENTS - TERM INSURANCE

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MR. MELVILLE YOUNG: Three years ago, many term writers and reinsurers were mired in red ink and the prognosis for term insurance was very bleak. In the last three years we have seen many companies take steps along brand new lines to help make their term business a profitable and growing business once again and we've seen a resurgence of term.

MR. ROBERT L. WHITNEY: The A.L. Williams Agency's face amount production has grown from 10.4 billion dollars in 1982 to 23.7 billion dollars in 1983 to 38.3 billion dollars in 1984. That 1984 production is more insurance than any other company. Prudential paid for $38.2 billion, if you include universal life (UL) and other products sold by their subsidiaries.

Our average-size policy is more than four times greater than Prudential's. They sell a lot more policies than we do. My crystal ball is vague about 1985, but it would not surprise me if at some point in the future A.L. Williams builds a campaign around being number one in policies sold.

One Monday in early November 1984, applications totaling one billion dollars of face amount reached the administrative offices in Atlanta. Granted we've had lots of inflation, but it still was awesome last November to see the applications roll in by regular mail, some type of express mail and even by van from some of the nearby offices.

A.L. Williams sells nothing but term insurance. Our product has some interesting features, but nothing as esoteric as re-entry term. Ninety-five percent of our sales come from one product, term to eighty-five with premium increases every fifteen years. We have retained a limited link to the higher first premium often associated with deposit term. However, products with pure endowments became a minority of our sales in 1982 and were completely eliminated at the beginning of this year.

Our product has a base term policy and a term rider. The base policy provides the first $X of coverage where X ranges from $61,000 at the youngest ages and to $10,000 at the oldest ages.

Above X, which affectionately is called a minimax, coverage must be provided by a highly competitive rider. The minimax label is appropriate because the minimax amount is the maximum base policy face amount and also is the minimum face amount to qualify for the low cost rider on the life of the insured. For example, $150,000 coverage at age thirty-five, is met by a $48,000 base policy and a $102,000 rider.

The base policy premiums bear most of the administrative and commission costs and are front-end loaded. Rider premiums increase in year two, as well as every fifteen years. On the average, the second year total premium, including the rider premium, is 85 to 90 percent of the first year premium. At higher ages, there is typically a premium increase in year two. The renewal rider premiums range from $1.08 per thousand at age twenty-five to $2.03 per thousand at age thirty-five to $5.43 at age forty-five. The first year rates are $.79, $.88, $1.48, $3.12, at ages twenty-five, thirty-five, forty-five and fifty-five, respectively. Our base policy premiums are sex distinct; the rider premiums are not. This glimpse of our rates should give you some idea of the competitiveness of the rider.

A.L. Williams has some interest in nonsmoker rates but so far such rates have not been adopted. Cigarette smoking is asked about in the application for underwriting purposes. There is no evidence that too large a percentage of smokers is being attracted or that the percentage is increasing.

A rider is available on the life of a spouse regardless of the size of the base policy. We sell a lot of spouse rider coverage; in fact, a little over 25 percent of the total face amount is sold on the spouse. The main motivation is not commissions. Commission dollars on the spouse coverage are relatively minor.

Based on recent reductions in the minimax, it is anticipated that the average face amount per policy on our main product will grow to at least $169,000. This includes the spouse coverage previously mentioned as well as close to $5,000 in children coverage on about half of the applications. The $169,000 continues an upward trend in average face amount which we expect to continue.

A.L. Williams is probably well known for its replacement orientation. Actually, the percentage of nonreplacement business is higher than many people realize - approximately 45 percent. And in A.L. Williams we're very proud of how much more face amount is sold, particularly on the life of the spouse, when a policy is replaced. Also, it's interesting and perhaps not a total surprise, that we sell more insurance in a replacement situation than in a nonreplacement case.

Commissions fuel the engines of most life insurance organizations. A.L. Williams is no exception. About 90 percent of total first year commission dollars come from the base policy and the balance from the rider. The overall average first-year commission is roughly 100 percent of first-year premium. Coupled with nonexistent or minor commissions on annuities and typical mutual fund commissions, our field force receives less commissions per one thousand dollar face amount than is usual in most other forms of life insurance, this includes variable life (VL), UL, or some blend of excess interest whole life.

Under a long term agreement, A.L. Williams Agency has agreed to write exclusively for Massachusetts Indemnity and Life Insurance Company (MILICO). MILICO, in turn, has agreed to coinsure a sizable block of such sales back to A.L. Williams Life. A.L. Williams Life coinsured 17 percent of issues in 1980 through 1983. 1980 is the year A.L. Williams started selling for MILICO. The coinsured percentage is 30.62 percent for 1984 issues and 34.69 percent for 1985 issues. The exact share is a function of the prior year's production and will systematically approach 46.8 percent. The actuarial staff at A.L. Williams works closely with MILICO on both the design of policies and in following experience. Most of the experience reports are prepared by MILICO.

First-year persistency on recent issues has definitely improved. We are hopeful that this improvement will carry over to renewal years. A major part of this improvement is probably due to the introduction of low cost riders. 1984 issues, based on persistency through four and seven policy months are expected to have a first year lapse rate of about 23 percent. Lapse rates in years two and three have been in excess of the 11 - 12 percent pattern that we would like to see. This excess has minor impact on total profits.

Mortality is good. Actual to expected mortality ratios for insured males at all ages combined as a percentage of the 1965-70 Select and Ultimate Basic Tables are as follows:

	Exposure Period	
Policy Year	3/80 - 9/84	10/83 - 9/84
1	110%	100%
2	73	69
3	70	71
4	74	70
5	43	43

The higher ratios in year one are due to a mixture of deaths during the conditional receipt period and also due to an excess of accidental deaths. The most common accidental deaths are due to automobile accidents (some may be disguised suicides) and gunshot wounds. Disguised suicide is clearly antiselection but in addition something causes more accidental deaths, at all ages, in the beginning of a policy than those that occurred in 1965-70. Reinsureres have formally indicated that they have experienced somewhat similar accidental deaths. This phenomenon has not shown up in intercompany studies, but the latest published study is for experience in the 1979-80 policy year.

There is a general trend toward lower actual to expected ratios with advancing age. Naturally there are fluctuations and the trend is clearer in policy year one where there is more volume.

Female insured mortality tends to run at 60 to 70 percent of male insured mortality. Female spouse mortality is more favorable than female insured mortality. Male spouses have produced poor mortality. We've tightened up our underwriting and hope that that will change.

Our expense - or more acurately MILICO's expense performance - is also considered good. The volume and simplicity of product range may provide a competitive edge with a dramatic improvement in unit cost. The unit costs for acquisition in 1984 were fifty dollars per policy plus an amount which grades by age and averages twelve cents per one thousand dollars plus 1 percent of first year premium. A.L. Williams takes care of sales training, sales administration, and certain convention expenses out of its total commission. MILICO's sales overhead is essentially met by the 1 percent of premium charge. Maintenance expenses are twenty-four dollars per policy plus fifteen dollars per lapse without value and 2.6 percent of premium for total taxes, licenses, and fees.

Most agents start as part-timers. Frequently, the agents are teachers or coaches who are interested in making extra money. As the number of agents expands, the percentage who are teachers and coaches is probably reducing. Nevertheless, they remain a significant group. A.L. Williams part time agents are well trained. They must pass the same licensing standards and tests as full-time agents. A number of states have adopted fairly stringent requirements, such as forty hours of classroom training prior to taking the licensing test. To some extent, these standards were adopted in response to the emerging A.L. Williams phenomenon. But we have never resisted them and take constant measures to be sure they are fully observed. We require all prelicensees in all states to study the same comprehensive material about the industry and about A.L. Williams products, even if not always in a classroom setting.

There's a certain crusade to our marketing activity. Pleasantly, 99 percent of the crusaders follow directions and training, including completing a full and detailed application. The retention rate of part-timers, whether they stay part-time or become full-time, is lower than the industry's, which is on the low side anyway. We still avoid the massive subsidy costs most companies incur. No sales are allowed on the first interview, which is strictly for fact finding. Successful A.L. Williams agents are highly motivated and follow proven techniques, which avoid "arm-twisting."

Experienced life agents are virtually taboo. The reasons relate to quality of performance and emphasis on "wheeling and dealing." Art Williams preaches that if you do a good job for the consumer, the commission dollars will follow. Art Williams also preaches the importance of a caring and loyal attitude towards the people who report to you. I'm not sure whether these few words do justice to this matter, but it's a very important part of what A.L. Williams is all about.

We run into semi-cynical members of the life insurance industry who note that they believe in "Buy Term and Invest the Difference" but too often the difference does not get invested. At A.L. Williams, the difference does get invested.

Performance in annuities is modest, relative to mutual funds, although sales of a separate annuity policy - as opposed to a rider - are increasing due to a marketing emphasis on the IRA deduction. In 1984, annuity premium income was 47.5 million dollars.

Our sales of mutual funds are much more impressive. Sales of mutual funds have more than doubled in 1984 and are expected to exceed 350 million dollars in 1985. The number of licensed representatives has grown from 7,218 at the end of 1983 to over 11,000 currently. In short, the difference after buying term does get invested at A.L. Williams.

In the future, at A.L. Williams, the average face amount will continue to increase and cheaper term insurance will be offered. Cheaper insurance will be possible, because of improvements in mortality, persistency, and/or expenses. Cheaper term insurance is likely to be achieved by lowering the minimax, which will increase the relative importance of the low cost rider (many sales are on a money purchase basis,) or by introducing a product refinement, or both. We do not have a specific mission to sell middle America the amounts of individual coverage the industry thinks appropriate for upper America, but that's where we're headed and we're doing it without ART type coverages. Cheap term insurance on the life of the spouse will continue to be important. We do not like universal life for a variety of reasons which include the lack of an IRA deduction and bundling of protection and savings, so I do not see UL or Variable UL in our future. But growth will accelerate for some time to come.

MR. THOMAS SKIFF: In the last six months, Fireman's Fund has completed a transition that now has us totally out of the agent sold term business and only selling direct response term. We have been in the direct response business for about ten years, and in 1984, our premium for term insurance was about 50 million dollars with another 50 million dollars of other products. One division works with third party administrators (TPAs) who have the direct contact with the list holder. We've been fairly successful working with an administrator who deals with credit unions. We also work directly with some list holders like American Express. Both of these approaches are successful, but they do require different products and different considerations.

Marketing of direct response requires a very close association between the marketing and actuarial departments. Each list needs to have a product that is specifically and appropriately designed. You have to make an adjustment from one list to another in the response rate that you can expect from your mailing. The response rate is tied to the strength and quality of the sponsorship and to the ability of the sponsor to separate buyers from nonbuyers.

When I talk about the strength of the endorsement I do not just mean how strong the wording in the letter is. I mean whose name is on the outside of the envelope. The key in direct response marketing is getting the person to open it and read the one to five minute message that you have to give. Sponsorship by an employer has the closest tie. The second closest is a bank or a credit union - someone with noninsurance ties. The third closest is an association like the Society of Actuaries. Credit companies for which there are strict qualifications like American Express or Master Card would also be good sponsors. Credit cards that have less qualification, your typical oil company credit card, are the least desirable group. This is somewhat similar to cold calls.

The marketing and the list is also tied to persistency through the billing mechanism. The best billing mechanism is an add-on to an existing monthly bill. Regardless of the billing mechanism, the pattern remains the same across lists. Basically, a 3-2-1 pattern is 30 percent first year, 20 percent second, and 10 percent thereafter. In our better lists it is as low as 15 percent first year, 10 percent second, and 5 percent thereafter. That pattern remains the same even as the absolute level goes up and down. Direct billing is worse in direct response than it is in agent-sold business because of the impulse nature of the sale.

The impulse nature of the sale and the underwriting method impact mortality results. The application is designed to be completed in two to three minutes. We ask about three questions that determine in effect, whether or not you're dying. About 75 percent of the people deny they know they're dying, and their applications never get to an underwriter's desk. We do a medical information bureau (MIB) check on everyone and reserve the right to ask for attending physicians statements (APSs) and medicals when we feel they are necessary. The request for a medical is a polite way to decline since it's taken at the applicant's expense. This procedure weeds out the honestly ill people and protects us for our contestable period.

It puts some additional strain on both the underwriting department and the claims department to carefully look at claims during the first two years and to take appropriate action. The majority of deaths in the first two years are from violent means, and there is nothing we can do.

The method of underwriting also has an impact on the pattern of our mortality. Our select period ties very closely to our contestable period. By the third year we are close to ultimate mortality. Ultimate, of course, varies depending upon the list being solicited. You are counting on successful marketing efforts to protect you from severe antiselection.

If expenses are less than an exact science in dealing with agent produced business, it's even more of a problem in Direct Response. The major acquisition cost in direct response is the solicitation material which is fixed according to how many pieces you mail. The premium you receive to cover that cost is fixed by how many people return your applications. A more expensive package does not always mean a higher

response rate. We do a lot of testing to find the proper mix between the expense of solicitation and the response rate. The key is the cost per policy issued. The end result is often approximately equal to the first-year agent's commission and, in that sense, is not necessarily a more efficient means of distributing your product. Even if the solicitation material is equal to an agent's commission the rest of your expenses are not equal to agent-produced business. This is because we are collecting less information and have less options available. Therefore, our underwriting and issue expense is about 25 percent of what we would use on agent-produced business.

We haven't seen a great deal of competition at the policyholder level for lower premium rates. We do not have any indication that potential policyholders are comparing our rates with another company or another mailing that they recently received. We are seeing increased competition from the large list holders who want a bigger piece of the pie. They may ask for greater commission and administrative fees, or they may eliminate the agent originally involved in the case. Sometimes eliminating the agent also means eliminating the company associated with the agent.

Direct response marketing is not for everyone. Marketing is the key and there are few people who have the experience to do it right and doing it wrong can be very expensive. It can also be a major conflict within an agency plant since you will often be dealing directly with policyholders. However, for Fireman's Fund it was a good decision.

MR. GERALD S. KOPEL: The only "new" development in term insurance is that profit is once again emerging as one of our pricing parameters. There is definitely a future for term insurance because it still satisfies basic needs like low cost temporary coverage while the need is greatest. It is useful even in the face of interest-sensitive whole life products.

Select and ultimate (S&U) term products produced lower and lower rates almost monthly, fueled by optimistic assumptions as to lapse, mortality, and federal income tax considerations, like 818 (c) treatment. S&U term insurance lent itself to manipulation by both insureds and agents, with demands for earlier reentry periods, leading ultimately to annual reentry products. Replacement was commonplace. On the reinsurance side, an ever increasing desire for market share supported the market and granted very high first-year allowances, which in effect financed the business.

The inherent flaws in the product encouraged poor persistency and led to first year lapse rates as high as 40 percent and a level 30 percent for several years thereafter.

Mortality was spurred on by the high lapse rates and a problem in financial underwriting. Grocery clerks were walking away with $500,000 policies. The reason I mention grocery clerks is that we had a death claim on a grocery clerk for $500,000. This led to a lot of questions. The reinsurers were getting hurt even worse than the primary companies. While the number of claims had not risen drastically above what we expected, the size of the claim had. The excess above

retention was swallowed by the reinsurer. Huge GAAP losses were experienced both by reinsurers and primary companies.

Finally, there was a general pullback in pricing. Suddenly the lowest set of rates didn't become obsolete one month later. Commission levels were reduced and levelized. Lapse and mortality assumptions used in pricing were scrutinized. Reinsurers stressed and tightened financial underwriting. High front-end allowances were no longer offered and replacement underwriting was instituted. In a typical replacement underwriting program if the current policy was replacing another policy issued in the last two years or was the second replacement in the last five years, either level allowances would be offered or annual renewable term (ART) rates would be used. In some cases, the policy was declined. Although this program could not be effective on an automatic basis without the help of the primary company, word started getting out to the agents that replacement abuse would no longer be tolerated. One company even said that level commissions would be offered to the agent unless a nonreplacement statement was signed by the insured in addition to the one signed by the agent.

A lot of our problems now seem to have turned around. Many companies whose lapse rates were 30 percent two years ago have begun to report rates of 17 or 18 percent, and these are big term writers. The long term mortality anti-selection on this type of business can still be expected but improved persistency will help lessen the blow.

Despite problems there are some companies writing S&U term in a particular marketplace where it makes sense and they are controlling and writing it profitably. Perhaps when their UL sales become a big part of their overall portfolio, they will be able to change to a different type of term product.

Some reinsurance companies have pulled out of S&U term altogether, both on new business and with existing clients. Others have tightened up their terms but continue on with old clients and others will take on new products but with much more stringent terms. Typical terms for a new product provide less than 100 percent first-year allowances coupled with very strict pricing assumptions.

Financial underwriting has been tightened by almost all reinsurers. Seminars and talks were held with the primary companies stressing the importance of financial underwriting. Replacement underwriting programs have been instituted by almost all reinsurers. Full retention is now a must. Reduced retention programs on selected products or segments of products, such as smoker only, will no longer be tolerated. By letting companies keep reduced retention, we gave them a locked in profit and shifted all the risk to the reinsurers.

Reinsurers are taking a hard look at the huge binding authority enjoyed by some companies with a view towards tightening it and making it more realistic. They are also scrutinizing products which are not differentiated by smoking habits, since it appears that these products are highly susceptible to antiselection by smokers. Our studies show that while nonsmoking mortality is just about as expected,

nondifferentiated mortality is much higher than expected. Unless there is a legitimate reason for not differentiating smoking habits, pricing will be heavily weighted towards the smoker side.

Today's new term products are actually the standard products of five to ten years ago. Old fashioned aggregate ART plans and level-premium five and ten-year renewable term products are the most common. Some of these have few frills, such as automatic conversion to UL, or reversions with evidence of insurability, or pure endowment bonuses at some point. Some products appear select and ultimate in nature, but upon closer examination, are not. The premium at issue age thirty-five duration eight is less than the premium for issue age forty two duration one. Therefore there is no incentive to revert or replace. We are also seeing deposit term products and high-low term products with a high first year and very low competitive renewal premiums. All the products encourage persistency.

Most companies have a market strategy for selling these new term products which encompasses most of the following points:

1. The field force will sell persistency.
2. The marketing department will illustrate commission dollars to the agent, not percentages, to let them know that higher premiums will mean higher commissions.
3. A five or ten-year net cost will be stressed.
4. More than one product will be developed, so the agent has alternatives.
5. Companies will be encouraged to pick their spots and try not to be all things to all people.
6. Companies will be encouraged to be proactive not reactive.
7. Profit and not premium will be emphasized to the field force. Most companies realize that term volume in the coming years will be down but hopefully profits will be up.

Moving to internal replacement programs, the most important question is whether it makes sense economically from your company's point of view. A rush to exchange inforce policies to your current UL product might result in high costs to your company if you're granting some first-year commissions. Model office studies of several different scenarios should be done before the decision is made. The general reinsurance industry position on internal exchanges (including term conversions to UL) is that the reinsurance should remain with the original reinsurer. Most reinsurers will not accept liability under the new policy, even if they are the automatic reinsurer, without a written release from the current reinsurer. They would treat these exchanges as a continuation of coverage and would use point-in-sale ART rates based on the original age. If the policy was coinsured, renewal allowances should apply. If requested, a reinsurer would most likely be willing to take something away from renewals and give something more in the first year to provide some relief.

Another area of reinsurance availability is the area of external term to permanent replacement programs. The permanent usually is some form of interest-sensitive whole life. These replacements will usually be guaranteed or simplified issue. It would be very difficult in today's market to find reinsurance support for guaranteed issue replacement programs. Most such programs have fallen within the retention of the company doing it. Most reinsurers would not want to touch them for a number of reasons, not the least of which is poor mortality.

Reinsurance support for a simplified issue program can more easily be found and typical conditions might be as follows:

1. no increase in face amount;

2. a maximum policy issue of $500,000;

3. the use of simplified nonmedical and MIB's;

4. a new policy with suicide and incontestable clauses starting again;

5. no replacements if the inforce policy is more than five years old;

6. automatic reinsurance on the policy which is being replaced;

7. standard business only; (the main problem from a reinsurer's standpoint is that although the policy may be standard, we're not quite sure of the classification standards. Some of the policies coming from a top-notch company may have been shopped and taken standard under somebody else's underwriting criteria not ours.)

8. prior inforce with a similar underwriting philosophy;

9. a maximum age of sixty or sixty-five;

10. termination of the old policy.

The insurance industry, both direct writers and reinsurers, has come through some hard times in the last few years. I worry whether in our rush to UL products we're not beginning to make the same mistakes in pricing assumptions that we made on term policies in the past. Companies are illustrating and paying higher interest rates than can be justified and are getting a much lower spread than they are pricing for.

MR. YOUNG: What's the range of response rates from the best to the worst with different kinds of credit card lists.

MR. SKIFF: Response rates range from under two-tenths of one percent to over one percent. The over one percent was probably with a follow-up mailing, not a single mailing, so the effective cost was for two mailings.

MR. LARRY RUBIN: Mr. Skiff, do you limit the face amount on direct response to reduce antiselection?

MR. SKIFF: The package usually has three to five face amount options. We try to eliminate people who already have the maximum that we're willing to keep.

MR. ZAFAR RASHID: You made a big point about the changes taking place in the term insurance marketplace with regard to S&U products. You also mentioned that you haven't seen very many new S&U products, at least at your company. I wonder if that doesn't overstate the change and I wonder how many companies are actually pulling S&U term products. I get the impression that while companies aren't developing new S&U products, very few companies are actually withdrawing their products or making significant changes like levelizing commission scales.

MR. KOPEL: I think there are quite a few companies that are pulling their S&U term products. A lot depends upon the marketplace. Some of the small writers who had a defensive product or something that they added after everyone else did, are the easiest to convince to pull the product. The big writers who depend on that product to a great extent are harder to convince. As UL becomes a bigger part of their business they will start pulling the S&U products.

MR. YOUNG: I'm not aware of any term writers who haven't done something to their product. For instance, the bimonthly reduction in rates have stopped. I am not aware of any major term writers who haven't reduced first-year commissions or added some kind of persistency underwriting program.

There are quite a number of companies that still have their product on the market, and I question whether they really have a handle on their true profitability. It's a product that's nearly impossible to price accurately.

MR. JOHN CASTELLINO: Mr. Kopel, I was somewhat concerned with your remarks about external replacement programs. Could you elaborate on the justification of supporting such programs?

MR. KOPEL: I am not encouraging these programs. They are available from some reinsurers. The available simplified issue programs do not give the same first-year allowances that would normally be grated on regularly, fully underwritten business, so there is a leveling or a cost recognition in the programs. There are a lot of people who support simplified issue programs. Guarantee issue programs are not a good idea.

MR. YOUNG: Those programs are generally ill advised, and most people agree that guaranteed issue programs are a sure loser. I've had several conversations with general agents of one of the major California companies who began this type of program. They acknowledge that the business that company is getting from their agency is suspect and will undoubtedly lose money. They will lose money because they are not

paying full first-year commissions. If an agent has a healthy insured he's not going to put it through that program. Those reinsurers that have done something with modified programs are trying to support clients who feel that they need to have something on the market in order to compete. The restrictions imposed are such that, at least in our experience, the programs never meet market acceptance. They just die. The fact that somebody's got something doesn't necessarily mean that it's being sold to any great extent.

MR. KOPPEL: The simplified issue programs do not do very much for the company or for their agents.

MR. WHITNEY: I have been asked, "What is done to avoid disappointment for those over age 85." To avoid disappointment for those age eighty-five and over, we have a decreasing term to age one hundred option in all of our policies. Most of our proposals assume that the policy converts to this option at either the end of fifteen or thirty years. You need more insurance while your children are growing up and if you follow the savings program, you will not need as much life insurance later on.

Our attitudes about whole life insurance and the advantages of buy term and invest the difference can get powerful. One example of this is a brochure which illustrates that the policy that was replaced would have provided the beneficiary $10,000 or $25,000, but our coverage provides $100,000. This is done for a dozen or so actual claim situations. We also include policies where there is no replacement. The question winds up with "why is this considered ethical?" Well, ethical can be a gray area. I would have to say that we believe in our product, we believe that we make a fair presentation, and we follow the replacement practices rigorously. When you have forty thousand or more agents, there may be some extreme statements but the policy from the top is certainly not to do anything that would be considered unethical.

MR. KOPEL: I have a two part question. "Are conversion allowances granted on first year conversions and is the agent then compensated on that allowance when applied to a permanent policy?" Most companies do grant conversion allowances in first-year conversion and, typically, the agent is not compensated on that allowance. One company went on a big conversion campaign to get their S&U term converted to their UL or some form of whole life. They asked the reinsurers to participate in compensating the agent on the conversion. The results of this program have been much better than even the company had hoped for and I think rather than moving from one percent conversion to two, they may have gone from one percent to six, so they consider the money well spent.

With respect to excess mortality, direct companies use classic pricing programs to estimate the cost. On the reinsurance side, we also adjust our mortality.

MR. YOUNG: Most reinsurers use point-in-scale ART rates, so there usually isn't a great deal of concern.

I have been asked if a company that has a S&U term policy, four to five-years-old, with very high premiums, should reissue all its own business to a new generation policy to reduce lapses?

Intuitively, we have always answered no. There have been three or four papers written in the last couple of years about S&U term and what happens to the mortality four or five years down the road. We studied this last year, did some programming, and developed a model. The parameters included what percentage of the insured population ceased to be first-year-select each year, and what the lapse rate is for those who are no longer first-year-select. The assumptions included what the underlying lapse rate is on the base S&U mortality table. We found that by the fifth or sixth year, virtually every policy that was still inforce and had been issued on a S&U basis experienced substandard mortality. The last thing that you would want to do for that block of business would be to reduce premiums.

MR. BILL CHEN: The key for the success of a S&U product is the quality of business written by your agency force. We introduced our S&U term in July 1982. We have monitored the persistency for this product every month since last year by face amount, number of policies, and premium. We have found our first year lapse rate to remain relatively constant at 17 percent. The reason why our first year is much better than the industry average, is that the majority of our business is written by general agents and not by brokers. Also, our large face amount policies have had better persistency than the low face amount policies. We are not a big writer of term insurance, but our first year exposure is around two billion dollars and our second year is about one and a half billion dollars, so our results are reasonably reliable. Our second year lapse is at 9-10 percent although I prefer to have some more exposure.

Second, we had a program to encourage internal replacement from the S&U term to UL. We have not had a significant volume convert, about forty million dollars. It seems that success is tied to the allowance with the reinsurer.

Third, we introduced our external replacement program about 6-8 months ago, and I was concerned about that program because of the antiselection in the industry. The majority of our external replacement under a simplified issue does not allow a face amount to increase.

I hope the reinsurers have some kind of distinction when dealing with different companies or in different marketplaces. For example, General Reinsurance has a corporate policy to terminate all S&U term business.

MR. YOUNG: There are certain companies with selected marketing forces that probably can write select term and not lose a great deal of money, but if you are a reinsurer servicing six hundred or one thousand clients, it doesn't serve you well to pick out the two or three or five companies that you think can successfully market the product. The rest of your clients probably don't want to hear why you chose to support their competitors and not them. They would much prefer to hear that you no longer support that product for anyone.