RECORD OF SOCIETY OF ACTUARIES
1988 VOL. 14 NO. 2

REINSURANCE PRACTICES UPDATE

Moderator: WAYNE D. BIDELMAN
Panelists: ANDREW F. BODINE
LARRY N. STERN
Recorder: WAYNE D. BIDELMAN

- o Update to the term insurance conference of 1983
- o Analysis of what went wrong
- o What corrective actions were taken and what were the results?
- o Where do we stand today?
- o Short memories -- are the term wars heating up again?
- o Analysis of what went wrong in the reinsurance marketplace

MR. WAYNE D. BIDELMAN: The purpose of the panel as I've tried to set it up is not only, as the program implies, to discuss the term insurance marketplace and the reinsurance thereon both past and present, but also to discuss the changing reinsurer/client relationship. We'd also like to discuss the evolving reinsurance and direct marketplaces and the interrelationships between those two marketplaces. I did not intend to make this just another group of reinsurers stating their woes about the past, the present, or whatever. We're trying to make sure that we also get the direct company perspective on these topics, though I will try to represent the reinsurer's view.

I'm going to ask Andy Bodine from Union Central to address the term insurance marketplace in the past and in the present. He can tell us about that from his own and his company's perspective, and he can add anything to do with reinsurance. Larry Stern from United Presidential is going to talk a little bit about his views and his company's perspective regarding the evolution of the relationship between the direct writing company and the reinsurers. I will finish off by giving the reinsurer's perspective on all those topics. I'll also discuss my view of the reinsurance marketplace in relationship to the direct marketplace.

Andy Bodine is Second Vice President and Actuary at Union Central. He's had many years of experience in both product development and reinsurance, with both small and large companies, and with both stock and mutual companies.

MR. ANDREW F. BODINE: Before we get into the April 1983 joint meeting in Chicago and the panel discussion that was so important for the select and ultimate term products, I thought I'd set the stage by giving a little history of what went on prior to those events. Perhaps some of you were either not there or wouldn't remember, and would appreciate the refresher course. I think back to what it meant to me at the time, and I'll be speaking from my own experience. Sometimes I'm surprised at the large amount of my experience that is shared by others, as well as how much others' experience is a lot different than mine. Hopefully, some of what I cover will hit home and be representative of the general industry experience.

In the early 1980s, I was with a very small mutual company that in two years went from selling about $30 million face amount of insurance a year to $2.4 billion a year. That's without acquisitions or any other reorganization. That is one heck of a jump for a small company to take and to be able to deal with the administration problems that come with it. Select and ultimate term was a very important part of that growth, and reinsurers played a significant role in how significant it was going to be.

Anyway, thinking back to those times, it's erroneous to consider the introduction of select and ultimate term in 1980-1981 as being the only significant change that occurred. There were two other major developments. One was that the paper by Michael J. Cowell and Brian L. Hirst on mortality differences by smoking class was delivered at the 1979 fall Society of Actuaries meeting in Miami (Mortality Differences Between Smokers and Nonsmokers, *Transactions* XXXII, Page 185). That led right into the nonsmoker select and ultimate term rates which were so powerful in the industry. That, in itself, laid the basis for a number of panel discussions and meetings. At the same time, after about five years of trying, the Tillinghast people located a small company to introduce what we now know as universal life. That company's product was called "total life." The universal life revolution occurred in 1981 and 1982. So, we had all three of these product changes happening at the same time.

Several other things were having an impact on the industry at this same time. For instance:

1. There was had computer technology. Personal computers (PCs) were just coming into being at this time, and people were learning about portable PCs, modems, and what kind of amazing uses were possible.
2. The 1980 CSO Model bills had just been introduced, with several new regulatory concepts for us. Were we all going to run to the new basis, or were we going to wait until 1988 to finally jump on the bandwagon?
3. Variable loan interest rates came in during the late 1970s or early 1980s. Do you remember the 20% interest rates in 1981?
4. The GAAP people were getting awfully excited about deferred acquisition costs.
5. Indeterminate rates became widespread to avoid deficiency reserves.
6. Wellness projects and preferred rate structures became more and more popular. People were trying to predict much lower mortality rates because of the wellness programs in which they were involved and underwriting selection of better classes.
7. Actuarial performance criteria developed by the Academy was started in these years.

About 20 years ago, when I was sitting in a meeting like this, I heard an older actuary say, "You know, when I was young I used to think things were aggressive and happening rapidly; but things are really changing fast now!" I'd say he understated what was going on then, and I'm wondering how much worse it can get. What is going to evolve in the next 20 years? How much can computers and other things make life change for us?

With reinsurers, there was a lot of competition in the early 1980s for market share. In that period, we saw many more attempts from the smaller reinsurance companies to make inroads. They weren't happy with just the big three or four companies sharing most of the reinsurance. The little fellows wanted a bigger piece.

Reinsurance allowances became extreme. We saw commission allowances of 120% plus 50 cents per $1,000, and situations were created where companies were really making more by sending their business to a reinsurer than by keeping it themselves. Reinsurers weren't just supplying surplus relief or mortality fluctuation relief; they were a source of income to the companies.

There were some unrealistic persistency and mortality assumptions among some reinsurers. Along with universal life and computers came self-administration, and the assumed cost savings to the reinsurers were passed along to the ceding company. Do any reinsurers see great savings in costs because of this self-administration? I suggest that administration costs have increased for reinsurers because of all the different self-administration schemes going on, and they have lost the ability to identify coverage on the same life from different ceding companies.

As for agents, they want the best of all worlds. Of course, this includes better products, lower premiums and higher commissions. In 1980, I heard an actuary making a comment that his company had found exactly what the agents wanted: a 200% first-year commission and a zero first-year premium.

In any event, first-year commissions on these select and ultimate term products turned out to be near 100% for the brokerage agencies. The brokers were working with computers so they knew instantly which companies had the hottest product out on the street. They could move products each year and get a new 100% commission on a lower premium. The problem was that renewals weren't enough for agents to live on, so they had to move the products again to get adequate continuing income. It turns out that rolling new 100% commissions became their livelihood, where they used to depend on cash value product sales with larger renewal commissions.

There was another change in the marketplace. This was about the time that agency-owned reinsurance companies came into being. This was when the agencies decided, "We can play reinsurer too. Let's affiliate with some company that will let us own part of the business and share some of the risk by reinsuring some of it. Then we'll share in some of the profits." There was also a lot of reflection that career agencies might have become a thing of the past. With personal-producing general agents (PPGAs) and broker organizations' nonloyalty and their skills in using personal computers, there wasn't any way that a company could restrict its sales and, therefore, afford the career agency expense commitments. That whole alignment was questioned, and I think we've seen a lot of subsequent shifting in agency organizations.

I'd like to touch on the experience in the early 1980s with the select and ultimate term products, which led to the term insurance conference in 1983 in Chicago. As far as lapse rates are concerned, some actuaries used to think of them as being a little higher than for traditionally designed term policies. With the traditional forms, some of the larger companies could look at their own experience. Linton B rates were a fairly typical term policy lapse assumption for a lot of smaller companies. They didn't have much else to go on. They developed select and ultimate term rates that they believed were priced conservatively with level lapses of 15% or 20%. In the early 1980s, they found that these products were coming up with about 25% to 30% first-year rates, 35% to 40% second-year rates, and probably 40% or so in the third year. It wasn't until after this that the few policies still left on the books got down to lower lapse rates, probably because they couldn't find any rates lower than highly

substandard available to them anymore. Their experience lapse rates were a whole lot higher than anyone had thought they would be.

There was also a much higher incidence of accidental death claims beginning to show up in the mortality experience. Financial underwriting was questioned. It had never been considered too important; we now had to consider gambling versus needs. If people went to an agent with $200 and found they could buy $400,000 of insurance at $.50 per $1,000, when they used to question whether they could afford $50,000 of insurance, they bought the $400,000 coverage. People bought a lot of insurance that they didn't really need or wouldn't otherwise have bought. Then, when accidents occurred, the insurance companies got hit with higher than expected claims.

Tax laws were also changing. We had the 818(c) reserve adjustments available, and a lot of the companies were pricing on the basis of tax gains to be made. There are a lot of different thoughts about this subject, all of which conclude it was a foolish thing to count on. One was that, with negative terminal reserves, there was nothing but net level reserves to be held anyway. There was no eligibility for 818(c). Another was that the government just wouldn't allow it because it was too much of an abuse. I think we all are aware that the question still has not been settled. Another was that tax losses cannot reduce a zero current tax, so no gain is immediately seen. At the time, many people put a lot of 818(c) benefits on the books and went on year after year happy with the profit they thought they were making. It was suggested that companies could probably eliminate all mortality costs in their pricing and make a profit on the tax incentives alone.

That's some of the thinking that was going on, and my small company was trying to compete. Reinsurers were beginning to increase levels of support. One of our reinsurers shared with us the volume growth it had assumed. We had been giving them about $2 million face amount of reinsurance each year, and they thought that with this select and ultimate product we were probably going to give them $50 million of reinsurance. We had a $50,000 retention amount. At the end of three months, we had ceded $300 million of reinsurance to them. By the time they sent us the supplies of forms so we could get those policies processed, we were up to $500 million. Finally, we reached $1.8 billion and they said that was enough, they could not take any more. Then we had to renegotiate reinsurance treaty terms. The reinsurers began to be a little more sensitive, but we still had a pretty good agreement for the next round of reinsurance, when our sales volume peaked out at $2.4 billion.

I know my company was not the only one with this kind of experience. The reinsurers were getting a huge explosion in volume from several companies. A lot of it was replacement insurance. It was new, but it was on the same life, and it was issued again and again and again through different ceding companies. The reinsurers were getting concerned about all this volume of risk exposure, the lack of premium they were seeing, and the huge lapse rates they were getting.

When we came out with this select and ultimate rate term product, I was assured by our management that we would not allow reentry because we understood that the reentry activity was going to lead to bad mortality spirals, and we just couldn't live with that result. But, when push comes to shove, you don't tell your agent, "We'd rather you took it down the street instead of allowing us to rewrite the policy." You know it's a healthy life; the agent doesn't understand

all the implications about taking the healthy lives out and giving them a new select rate product. How do you explain to the agents what happens with the remaining bad lives? The agents haven't the foggiest idea what you're talking about. Their eyes glaze over, and they're not interested in actuarial discussions. It's very difficult for a company which is currently selling a select and ultimate term product to tell its agent it won't allow him to exchange current inforce business for a new product. "We won't allow you to terminate the policy and take out a new application." But that's the theory that is needed in order to make those who paid the select rates earlier stay with you and pay the ultimate rates later. The real world doesn't operate that way.

Now let's discuss the April 1983 meeting in Chicago. Regarding select mortality analysis, Robert D. Shapiro and John B. Snyder wrote an excellent paper, Mortality Expectations Under Renewability, for the Conference of Actuaries in Public Practice, *Proceedings* Volume 30, Page 92, analyzing the many different items that impacted an insured's desire to antiselect. What would influence him to exchange, when would we have a high or low exchange rate, and what would happen to overall mortality under various scenarios? The scare scenario was that mortality could be 10 or 20 times worse than expected out beyond the 10th or 15th year. The antiselection has a minimal effect in the first few years of exchange activity, and you don't recognize it. What you've really bought, though, is a long-term problem. This is because the insured always has the ability to reenter on a more favorable basis. This leaves only the uninsurables willing to stay with the product guarantees, because it's better than any new product they can buy on the street. This has always been true, but this product design greatly increases rates of chance to select against a company.

What about expected mortality on the reentered select life? Was it really fresh? Were underwriters really taking that man who wanted to reenter and giving him a full, thorough investigation such as they would a new applicant? They were possibly only giving him a short form that said, "Has your insurability situation changed? If not, sign here and we'll give you a new product." I think there were some who called it aggressive underwriting to retain business, and there was also some aggressive actuarial work done to justify some rash assumptions.

At the panel discussion in Chicago, of which I was privileged to be a part, there were about 14 of us sitting on the stage sharing experiences. I was second from the last, and when it got to be my turn I just said, "Me, too." We had all seen the same high mortality and high lapses as the others.

Let me focus at this point on what was being done to correct the situation. This was the objective of the panel, and it was time to turn around the snowball that was rolling.

1. Identifying a policy being moved from company to company and underwriting for persistency came into play. Reinsurers said they were no longer going to take any policy that had been replaced in the last year or two years. That was an excellent first step to take.

2. Reinsurance allowances for new business were reduced. Reinsurers were no longer as aggressive in making it a source of profit for ceding companies.

3. Financial underwriting was identified as being very significant. That was a key to the high accidental death rates that were occurring, and companies had to stop issuing that much insurance to those who didn't really need it.

I think this remains an important point for many insurers today, and there is continuing bad experience for companies which downplay the importance of financial underwriting.

4. Unrealistic actuarial assumptions were also labeled as a cause of the problems. There were faulty concepts about agency loyalty, lapse rates, tax credits, and mortality projections. They needed to be levelized to reduce replacement motivation. But this idea has been around for many years without progress in achieving this goal.

5. Some consideration was given to commission patterns.

6. Market share had to stop being the critical objective for reinsurers; bottom line profitability based on reasonable assumptions was needed.

So that was the list of items identified by the panel as needing to be changed. What's happened since then? In my company, the recent situation seems to be that if we never bring up the subject of term insurance no one else will either. From 1983 to 1987, the interest seemed to shift to permanent plans. We're talking about variable whole life and universal life with high interest rates. We're talking about products like complife, which is whole life with paid-up additions and term riders. We're talking about work on 1980 CSO cash value product compliance. We're talking about a lot of permanent plan activity, replacing traditional plans with new plans. The agents and the companies seemed to have their hands full with permanent cash value products, interest-sensitive products, equity based or nonequity based.

For a while, no one seemed to bring up the subject of term insurance. But if you brought the subject up and if you brought it into focus, you could get a lot of term product discussion. People still remembered the relative near past and could talk about what they'd like to have. They'd say that their agents were still hurting since they pulled that select and ultimate term product; that they were losing business; and that they should get more aggressive. But again, I found that if you didn't bring it up there was virtually no interest. I think that's changing again a little bit now. We're now getting back into higher field concern about term products.

Another set of popular products that has developed in recent years is single premium whole life; you know, the one with zero loan interest, and zero mortality charges, and problems with long-term projected benefit amounts. Someone could buy the single premium whole life policy with a minimum corridor of life insurance that might be only a million dollars today and $30 million 40 years later. The problem now is to try and find a reinsurer or retrocession outlet that will accept that $30 million projected benefit. That's quite a problem for our business. We learned about this problem the same way I think many others did, after it was already on the books and we were working out how to handle administration for retention under those projections.

Anyway, term product sanity largely returned to the marketplace. There are still some select and ultimate products being sold, probably at lower commission rates. I have heard that the first companies to go to levelized commissions had a drastic reduction in the volume of sales.

Interest rates have reduced, and the universal life has largely completed its replacement activity, so now the permanent plan to universal life exchange is

harder to sell. Now we have to go out and sell the new policy instead of just replacing an old one. With reducing interest rates, we've seen dividends and interest rate credits reduced, and vanishing premiums have reappeared. We're not sure about what we are going to do. No one has recognized that the world has changed and that the sales objectives companies had in the past can't continue in this environment. They should be reduced. In terms of face amount of insurance, how are the sales objectives going to be met? I'm afraid this situation is one reason we're back to term wars heating up again. And this is putting pressures on the underwriters and actuaries to become more liberal. Are there many actuaries who, in pricing an aggressive term product today, find they can do it with adequate conversion costs included in their pricing structure? I suspect some actuaries aren't including any cost of conversion in their pricing.

Speaking of conversion, I get concerned about conversion of term to universal life. That can easily be a term-to-term conversion; that's not a term-to-permanent conversion. Does anyone else worry about the results to which conversions to universal life can lead if there are too many of them?

I think we're better situated now to cope with the term wars; better smoker/nonsmoker statistics are now available. Back in the early 1980s, right after the Cowell/Hirst paper came out, we only had a lot of presumptions and assumptions about smoking class mortality. Now we have John Bragg's work[1] one and some other better sources of smoker and nonsmoker statistics. We've got a better feel, ten years later, from looking at statistics on larger volumes of policies originally written with distinct smoker/nonsmoker rates. This is compared with the Surgeon General's Report and assuming a 65/35% split, with a two-to-one smoker/nonsmoker ratio. Now we can analyze some real age-by-age distribution data.

Incidentally, if you haven't looked at some real live experience data, you should. There are some surprises, such as smoker rates at the younger ages. There's little or no margin between them and the 1980 CSO Table, in spite of the intention that there should be some margin. You'll find, if you think in terms of eight quadrants (male/female, young age/low age, and smoker/nonsmoker), that higher age male nonsmokers are not trending quite as favorably as any other category. Why this difference? The attractiveness of lying about smoking status is so great that there's a lot of misrepresentation going on in this category.

Preferred risk classes are also coming back into vogue. Is this really true tight underwriting or just putting on a preferred label for marketing? Is it bait and switch? Is it just advertising about preferred risk? Do you have to be a super person to get a preferred rate policy? I have not yet seen, in what is now approaching 10 years of discussion about preferred rate categories, any statistics on how much mortality is reduced under various preferred classifications. I know rates go down when insureds are preferred, but I've never seen any statistics about it. If anyone has any source of good information on preferred rate mortality experience, I'd love them to share it with me.

Select rate schedules seem to be showing a little more resurgence of popularity. I wonder if it is believed that, just because select rates apply only after a

[1] Intercompany studies of smoker/nonsmoker and AIDS experience performed by Bragg Associates, 28 Lenox Pointe, N.E., Atlanta, Georgia 30324.

five-year period or a ten-year period, they're any different from what they used to be under a one-year period. I'd suggest that they're not any different; these select rate schedules just delay seeing the negative results a little longer. When an insured sees his select rate period coming to an end, he'll move to another new contract pretty quickly.

Maybe reduced first-year commissions are making some progress. I understand some companies are having some better success there. It's been long coming and it's slow. It's something that needs to be done, but I recognize it as one of the most difficult things to pull off.

Are expense assumptions reasonable? How about AIDS mortality costs and term insurance products? You've got a very low premium, and yet you've got to do more underwriting to select out AIDS. Are those costs covered in the new term rates? These term rates are pretty low. How are the expenses covered? What about the objective for the term sale? Is it short-range or long-range? Our field force says that they need a term product just to get a toe in the door, but it seems they either sell a product that's going to stay on the books for many years or one that's going to quickly lapse. I don't see a lot of conversion activity, which is why the agents seem to feel they want a good term product. There needs to be a match between the real use of the term product and how it's priced. Again, I'm getting back to reasonable assumptions regarding persistency.

Conversion bonuses also seem to be popular in new term products today. Are these products adequately priced? Where is the price for the bonus? Is it assumed to be in the new universal life product? As an aside, I think universal life products are priced too thinly today to meet their own mortality, much less to handle extra conversion costs from term products. Do the term products themselves provide for those conversion costs? I don't know, but I suspect they do not.

MR. BIDELMAN: Thanks, Andy, for covering the term insurance marketplace. Certainly it had a lot to do with the changing relationship between direct writers and reinsurers, as much as anything else.

I thought it might be useful to get the perspective of another type of carrier; Larry Stern is Senior Vice President and Chief Actuary at United Presidential Life in Kokomo, Indiana. Anyone that competes in the interest-sensitive product area knows that United Presidential has some of the most competitive products. Larry has had a lot of experience in developing those products and in developing relationships with reinsurers. Although he's responsible for all of the actuarial functions at United Presidential, his primary responsibility is in product development and setting up the reinsurance for those products.

MR. LARRY N. STERN: The purpose of my presentation is to comment on the relationship between the reinsurer and the direct writing company. For United Presidential, reinsurance has played a major role in the financial success we have experienced since our inception in 1965. I am sure our relationships have mirrored those of most other small companies in the industry.

As I said, United Presidential commenced business in 1965, primarily as a writer of substandard business in the late 1960s and early 1970s. We were heavy in the deposit term, ART, and select and ultimate term markets during the mid- to

late 1970s. In 1981, we introduced our first universal life product and have been a substantial writer of interest-sensitive products ever since.

At the end of the first quarter of 1988, we had roughly $6 billion of total inforce, of which $5.4 billion was in universal life and interest-sensitive life coverages. Of these, approximately one-third was reinsured with a number of reinsurance companies. In the past three to four years, we have produced anywhere from $1 to $1.5 billion of new volume each year and have reinsured roughly $400 to $500 million of those amounts each year.

Our marketing thrust has always been through independent agents associated with large marketing companies, financial planners, PPGAs and brokers. We offer no expense allowances, offices or fringe benefit plans -- just vested commissions. As you can see, we do not deal with career agency marketing systems. We view these agents as our customers, to whom we offer favorable compensation, competitive products for clients, and quick home office service. So, we're really operating to first attract agents to our company with the service, compensation and products for them to then market to their clients.

Our corporate objectives are all tied to our marketing effort. We have repeatedly selected reinsurance companies which reinforce this philosophy. I would like to trace the evolution of our current relationships and what I see as important considerations that we expect the reinsurers to provide for us in the future. We only market individual life insurance, so my remarks will be somewhat specific to this type of coverage.

The evolution of our current relationship starts back in the early stages of our corporate development. As an emerging small insurance company, we were more heavily concerned with new production. In the substandard arena, we sought reinsurer relationships which provided liberal underwriting philosophies and financial incentives for new production to offset surplus strain.

As we moved into the term war era of the 1970s, reinsurers were looked upon as profit sources for direct writing companies. The actuaries dealt with the pricing and financial side of reinsurance. The underwriters dealt with risk appraisal. Claims administrators handled paper transfers. There was very little, if any, cross-communication among and within the functional participants. Service capabilities were limited due to postal constraints. Quick turnaround was not essential, but case placement was.

The introduction of universal life has brought a whole new light to reinsurance relationships. At United Presidential, we were early believers in the product and the impact it could have on the industry. We also realized that our underwriting philosophy would undergo drastic changes to support the nature of the product as we completely abandoned the substandard market. We were fortunate to have an automated system which could issue and administer the product. Because universal life was priced on a leaner, tighter profit margin basis within the direct writing company, an interdepartmental cooperative spirit emerged. More interplay between the actuaries, the underwriters and the marketing personnel took place. Reinsurance pricing took on a more realistic perspective as well. Both reporting and administration performed by the writing company afforded expense economies, which were passed on through allowances. More attention is now being directed to service and assistance.

In the past five years, we have seen our company triple in size; assets, surplus, and insurance in force. We started with two automatic reinsurers and an additional facultative outlet. We now have four automatics plus two additional facultative outlets. We view the reinsurer as an extension of our staff. As such, we have selected companies which can identify with our marketing philosophy. Ninety-five percent of our issued cases are "vanilla," what we consider our "bread and butter" standard. We offer quick turnaround in underwriting and issue, 5 days or less. We expect our reinsurers to live up to this performance, and for the most part they do.

How is this relationship changing? Because of our service commitment to agents, we have selected reinsurers who understand direct company mentality. Underwriting is interpretation and judgment; each case has its own set of circumstances. Our underwriters understand our agents -- how they market and how they use insurance and financial planning. The reinsurers must also have a feel for the same. We want them to become involved in case placement. We have found that those reinsurers who have direct writing counterparts under their corporate structure have a better understanding of our position when we ask for underwriting assistance. We have also selected a reinsurer who does not have a direct writing counterpart, because it has commonly employed underwriters with direct company experience, in efforts to better understand the direct company marketing position. We have experienced more liberal approaches to underwriting and quicker turnaround from these companies. There is also less likelihood that they will request additional information when we submit our regular underwriting requirements for facultative cases.

Since the reinsurer is viewed as an extension of our staff, there is more direct communication. There is more willingness to negotiate on facultative cases and offer opinions on automatic business. We were seriously negotiating with a large marketing organization to establish an agent-owned reinsurance company. We were able to tap the resources of one of our reinsurers to assist and back us up during this process. Its input was most valuable. The increased direct communication has resulted in more face-to-face meetings, and not just more frequent visits from the reinsurance marketing representative, but occasional visits by the underwriters and the actuaries as well. We have even sent our staff to the reinsurance companies for these exchanges and for extensive training. The reinsurers are becoming much more service oriented.

We were recently faced with an underwriting shortage due to illness and a large influx of new business. We were fortunate to be able to borrow an underwriter from one of our automatic companies to cover the crunch. Both companies benefited from this exposure. We were able to maintain service standards, and the reinsurer gained a better perspective of our procedures and philosophy.

This cooperative spirit has created better understanding among companies. It tightens the bonds of relationship, making all parties feel more comfortable. Reinsurance is still just a gentlemen's agreement. There is less tendency on the part of the direct writing company to take advantage of or abuse the automatic relationship when there is better understanding among the parties.

What is the direction of the reinsurance relationship for the future? What do we expect? As you can tell from some of my previous remarks, we place a high degree of importance on service. We know we'll not always have the best competitive product or pay the highest commission, so in order to retain the level of production for many producers we need to continue to woo them with service

capabilities. We will need to rely heavily on the reinsurers to reinforce our service commitment. For underwriting to be state of the art we will expect timely updates to manuals, reflecting changes in current health and medical practices. We will also expect speedy service in response to underwriting requests.

The reinsurers must stay abreast of technical equipment for transferring material. The facsimile equipment has become an invaluable tool, which has shortened response time not only on the front end when underwriting is performed, but also on the back end with claims. We can transmit claim papers to the reinsurers the same day we receive them, so their processing commences concurrent with ours. This allows claims to be settled quicker. With the shorter settlement time, the amount of required interest payable with a death claim is also reduced, especially in states where 12% is the rule. We have even wire transferred monies in an effort to speed the processing on large cases.

We also rely on the reinsurer to share data gathering results. Of particular note recently has been the blood testing limits on AIDS. The exposure to a larger base of companies enables the reinsurer to collect the data quicker and more efficiently than the direct writing company. Although there has been no reluctance to share the results of these surveys with us, there has been a reluctance to identify which companies are involved. Knowing our competitor's position helps substantiate our position when dealing with agent pressures to make exceptions in the underwriting process.

In short, we don't expect the future service to be any less than in the past. Speaking as a pricing actuary who negotiates reinsurance treaties for our company, we'll even expect a few more percentages added to the allowances that you give us!

I hope my remarks have demonstrated that we value our relationship with the reinsurance companies. The bonds have become closer, more admonitorial with time, and we expect this to continue.

MR. BIDELMAN: I want to give a little bit from the reinsurer's perspective. We've heard two direct writers now. I'll try not to belabor the same points that many of you have heard before.

At Security Life of Denver, I'm Senior Vice President responsible for both the outgoing reinsurance as well as for our assumed reinsurance operation; however, I will try to give the perspective of simply a reinsurer. I've always been intrigued, perhaps somewhat philosophically, by the relationship between the client and the reinsurer and maybe even more so between the two marketplaces. The reinsurers really do operate in a different kind of marketplace than the direct writers. Although obviously both the direct and reinsurance marketplaces are reflective of each other, the relationship is very important. Whether people want to hear it or not, I usually think it's advantageous to describe situations from the reinsurer's perspective so that the direct writers understand their problems and their concerns a little bit more. That way, maybe the relationships can be put together on a much more beneficial and long-term basis. We do want that long-term relationship between the ceding company and the reinsurers; both sides want it.

I promise not to belabor the historical events; however, I really think, from a reinsurer's perspective, that it's important. I'm going to go over it very

quickly. I've now been in the reinsurance business for about 14 years. I was intrigued at how tough it was to find other key reinsurance people who were around back in the late 1970s and who are still working for reinsurance companies today. I was hoping they might be able to fill in and give that perspective. While there are still some, there have been significant changes in the reinsurers and the reinsurance marketplace. I've been somewhat intrigued that, within the 14 years I've been involved, it seems like all the significant change, the significant evolution in the reinsurance marketplace, has really taken place within that period of time.

Maybe that's just my perspective. On the other hand, I could almost summarize everything prior to the 1970s in one sentence. Basically, everyone in the insurance business was making quite a bit of money. Ceding companies didn't really care what they paid for reinsurance at that time. They had a lot of margin in their products. The important thing at that time was what the reinsurer was providing in services. Who provided the things that they really needed at that point in their development? Also at that time, if you think about it, there weren't nearly as many reinsurers as there are now. In my mind, that is what depicted the entire history of the reinsurance marketplace prior to the mid-1970s.

I think a very significant period of time was the mid- to late 1970s. It was sort of a transition era in my mind, again purely from the reinsurer's perspective, and there were many, many new entrants into the reinsurance marketplace. All of a sudden the number of reinsurers doubled, even tripled. Many of foreign origin were coming into the reinsurance marketplace. If you enter a new market, how do you compete? Obviously, you can only do it by either aggressive pricing of the reinsurance or aggressive underwriting. In many cases, competing was necessary because they needed to figure out an inroad to a new marketplace.

Secondarily, there were some reinsurers, including my own, that were trying to cut out a niche in the marketplace by saying that eventually the medium to larger size companies were going to have to decide that reinsurance was a real cost. They didn't need to pay high prices for high service, and maybe they'd start becoming conscious of the fact, since it is a cost of doing business. They could eliminate some cost by going to a reinsurer that was primarily concentrating on price. A couple of things were going on here that were starting to generate fuel for the fire, if you will.

Then there was the period of time that Andy described, the term wars era. This period was roughly 1978 or 1979, maybe up through 1983. I think this period, as most of us would say, represented the maximum historical aggressiveness by the reinsurers. A lot of this was fueled by the fact that we had many new reinsurers, as I described. The major reinsurers felt that in order to keep their long-term profitability, they had to keep a lion's share of the market; so there was market share competition. Unfortunately, the economy was not the best at that time either. We had high inflation, and we had high interest rates. Our permanent products were going out of vogue, forcing most of the direct writers to go to a term insurance product. As we all recognize, about the only way to compete on a term insurance basis is with price. So a direct marketplace was competing highly on price, and a reinsurance marketplace was all fueled up and going after market share, etc. A price spiral developed that was very difficult to get out of, as Andy described.

Right around 1983, about the time of the term insurance conference that Andy talked about, there was a turning point from a reinsurer's marketplace standpoint. I usually call it the "fall-out" era. All of a sudden, many of the reinsurers were starting to realize significant financial losses, and they had to do something about it. I'm sure you've all seen this. Reinsurers have withdrawn from reinsuring some products. They've pulled back on their facultative underwriting. They've pulled back on their aggressive pricing. Some have pulled out of the business entirely. This represents a massive change in our reinsurance marketplace.

Those who know how I like to describe the reinsurance marketplace also know that I love the definition of reinsurance as being the wholesale marketplace behind the retail marketplace of the direct operation. Just like in a commodity business, direct writers sell the product at the retail level, and the reinsurers are there behind them on a wholesale level. (My company had a direct agency director who used to call reinsurance "used insurance," a term which I quit using a long time ago. He thought he was selling new insurance and I was selling used insurance.) I think the wholesale concept is not a bad one for determining out how the direct and reinsurance marketplaces interrelate. Certainly they are reflective of each other, but I like to discuss whether the retail marketplace is a reflection of the wholesale marketplace or vice versa. Has there, in fact, been a shift?

If I were to describe what reinsurers are faced with today, I'd have to say that they are, and have been for some time, in a totally term marketplace. For a while, the direct marketplace was virtually nothing but term insurance; obviously, the reinsurer was only involved in term insurance then. But even with the advent of interest-sensitive products, universal life, etc., direct writing companies are not very interested in ceding the investment risk. They want to keep that action themselves. So, the primary traditional reinsurance activity in the marketplace is transferring only the mortality risk. And that, of course, is term insurance. Reinsurers are only coinsuring term products, coinsuring internal costs of insurance rates, or just YRT reinsuring. Again, they've been in a term-only type marketplace from the reinsurance perspective for some time. Of course, that makes the market extremely price sensitive and very price competitive.

The reinsurers have had to have sharp pencils for some time now because of that type of activity. For example, they don't really get to share in any of the investment action. Being the wholesaler in the business, obviously, the price of term insurance has to fit comfortably inside the retail price, inside the risk charge that the direct writing company has built in for the mortality risk. Just like direct writing companies, reinsurers have to be extremely cautious of their expense level while still keeping up their level of service. This is important to all of us.

Another thing that I think is often forgotten is that reinsurers have to review, price, and analyze virtually every creative idea any pricing actuary has ever come up with. This sometimes puts the reinsurer in a rather difficult position. It certainly suggests the need for the direct writers and reinsurers to talk to each other. It's possible that the direct writer has done an immense amount of research in a new area that the reinsurer perhaps has never seen before. In this case the reinsurer, who wants to be of service and who has highly professional individuals, should be used as a sounding board or reaction device -- not to be asked to give a quote with no sharing of information. Again, we've got to

appreciate that the reinsurer's going to see every creative idea and be asked to analyze it. I always think of reinsurers as being almost exactly like consulting actuaries. Unfortunately, though, they don't get paid by the hour; they only get paid if they get the reinsurance account.

This consulting also puts the reinsurer at a real risk of nondisclosure from the ceding company. This means that if you're going to get into an experimental area, you need to work back and forth with your reinsurers; it's important that you both understand the process as best possible and come up with the right kind of reinsurance program.

So, from a reinsurer's perspective, how would I view the current reinsurance marketplace? Unfortunately, I think the reinsurers are in an overcapacity situation right now. I think there are more reinsurers than reinsurance business. As a result, it's still a bit of a buyer's market. Due to the past, I think a lot of reinsurers look at it as a "seller beware" marketplace. Some reinsurers are even pretty vindictive toward the marketplace because of the problems they've had in the past. I'm not even sure some of them recognize that they put a lot of their problems on themselves, as opposed to their clients being at fault. It's still a buyer's market, and some reinsurers are a little touchy at the moment.

Unfortunately, I think we may well be in a similar type of price spiral today as we were back in the term wars era, but with a different thrust than before. I think the term wars back in the late 1970s and early 1980s were, without question, fueled by the reinsurers. As I mentioned, the real thrust was an overcapacity marketplace, and the reinsurance marketplace was forcing the reinsurers to be more aggressive. As a result, the direct marketplace was forced into being more aggressive.

I don't view the situation now in quite the same way. I think that most of the thrust for the decreased margins today is coming from the direct marketplace, not the reinsurance marketplace. In fact, I would submit that the biggest problem we have today is what I call the era of unprecedented direct marketing pressure. You might say, "Gee, since the beginning of time in the insurance business, we've always had marketing pressure. The marketing people are always asking us to come up with new variations on products, a lower-priced product, different riders, higher commissions." I think that's true, but the important point is that the pressure is unprecedented at this particular point in time. At least from my perspective, there's never been a time when there's been such similarity between products, between one direct writer and another. As a result, the only way to have any product differentiation is to come up with product variations and lower the price. I view the current price pressure as coming much more from the direct marketplace than from the reinsurers.

I'd also submit that there's a great deal of danger in looking for the reinsurers to police the too aggressive activity and keep it from going on. You have to appreciate that, from the reinsurer's standpoint, they are in an overcapacity position. It is a very competitive marketplace. Reinsurers are atuned to providing service to their clients. They don't want to say no. Particularly with long-lasting clients, they're going to try and rationalize supporting a client as opposed to saying no. I would just submit that it could be dangerous to expect reinsurers to call a halt to all the aggressiveness that's going on in the marketplace. Things are different today than they were back in what we call the term war days. In fact, I would suggest, and I think Andy alluded to this, that I

think the reinsurers aren't anywhere near as aggressive as they were back in that time. They may still be too aggressive, and I think the current scenario is just as dangerous as what went on in the past, but there's one little difference. At least from my perspective, I think the most aggressive reinsurers out there right now are trying to support the most aggressive direct writers. If the results aren't good this time, the reinsurers will not only take a bath but so will the direct writers!

MR. JOHN O. MONTGOMERY: What are you doing about AIDS? I'm concerned that reinsurers are not recognizing the risk properly and that many reinsurers that are involved, especially these newer reinsurers, may not know what they're getting into. They may not have enough surplus to withstand unexpected mortality. What's happening there? I'm very much concerned about the solvency of the reinsurance industry.

MR. BIDELMAN: Why is it more a reinsurer's problem than a direct writing problem?

MR. MONTGOMERY: Because the direct writers are transferring their risks to the reinsurers.

MR. BIDELMAN: But they aren't transferring all of the risk. I would submit that there's just as much a question on the direct side, particularly in the term insurance market, as there is on the reinsurance side.

MR. MONTGOMERY: My surveillance tests show that the surplus margins on the reinsurers are much thinner than they are on the direct writers. That's the problem.

MR. BIDELMAN: I think that is a possibility. I can't answer other than from my own standpoint. I don't think there's any question that, if you look at the AIDS statistics and price for what eventually could happen, everyone's tremendously underpriced. Basically, we are all trying to be conservative in our underlying mortality assumption at this point. We typically aren't reserving extra yet. I don't know if any other reinsurers would be willing to comment on what they're doing in that area.

MR. BODINE: From a direct writing company's point of view, I've tried to find out what our competition is doing to stay on top of it. I guess I see two ways to approach it. One is through pricing, or reserving for the extra deaths, and the other is through underwriting to control getting it. What I see happening is that control is the choice taken by most companies, with the resulting necessity for absorbing the costs of that control. The cost of the extra blood tests is part of the pricing process.

There's probably a fairly good comfort level as those who already have insurance in force are not in the high AIDS risk group. The high risk is the person who would now be trying or who recently has tried to get insurance. That's not a really great comfort level. I'd like to hear if others disagree.

MR. BIDELMAN: I think reinsurers have at least tried to carry the ball in terms of defining what we think are appropriate test limits. When in doubt as to how to handle the situation with existing insureds, at least you can try to view the selection process and try to suggest what seems to be the rational thing to do. I think the reinsurers have done a fairly decent job of that. My only

other statement is (and maybe this is a rationalization) that certainly 99% of the reinsurance business that reinsurers get today should be tested, unlike most of the ceding companies whose retentions are inside their test limits.

MR. MONTGOMERY: Are you using cash flow projections in any way to measure what your additional risk might be?

MR. BIDELMAN: My company has done some of that on the direct side, but at this time we haven't specifically done that on the reinsurance side.

MR. PAUL A. SCHUSTER: Listening to some of the comments, I get the impression that relationships today determine where reinsurance is placed. It's been my impression that price, and price alone, determines where the reinsurance is placed. I would be interested in some comments on that from the panelists.

MR. STERN: I will submit that, in the past, some of my selections of reinsurers have been on a price-for-price basis. These decisions were made without concentrating on what came in the underwriting area, assuming that just about all the reinsurers were providing the same or similar types of reinsurance assistance. That's not the case we have found of late. It's more than just a pricing analysis. We have had a great deal of lengthy discussion within our own company (my discussion with the underwriters and claims people) to get views on the service capabilities of the reinsurers. We have created for ourselves our own service commitments to the agents who produce our business, and we certainly want to be sure that the reinsurance community can back us up. So, it has become more than just a price-for-price type of relationship. Yes, prices are a deciding factor, but they're not the only deciding factor. There are discussions going on within our own company, within the other departments, with people that are more actively involved with reinsurers than I am on a daily basis.

MR. BODINE: In my company I work closely with the underwriters, and I wouldn't make a change in reinsurers without good communication with them. Some of the underwriters have been working with us on both automatic and facultative quotes. There are some specialty areas, certain areas in which the reinsurers have provided some extra assistance, and we would tolerate some participation in reinsuring new products with these reinsurers if they are not the lowest priced. I suggest to new reinsurers trying to get in the door that price is not the only way to do it. The best way is to develop, through facultative arrangements, a working relationship with the underwriters. At the proper time, when a new product comes out, they will have an opportunity to get on board with a regular pricing agreement.

MR. STERN: I would certainly agree with that.

MR. BIDELMAN: I'd have to say, from a reinsurer's prospective, that's the way I view it also. I think that's the way most companies are looking at it. I would submit that there is more of a squeeze now on the direct product margin and that there may be a limit to what they can pay for reinsurance, but it still only makes the price one of the criteria. I think it's still enough of a buyer's marketplace that it's possible to get a decent price that fits within your margins and still get the service from the reinsurers. This is part of the reason companies primarily used one reinsurer prior to the mid-1970s, and are now using pools of more than one reinsurer. Maybe you can't get the same price from all of them, but you certainly can get a wide variety of services from them. Plus, with the

changing facultative marketplace, a lot of reinsurers will not provide facultative coverage unless they have some of the automatic as well. That's another factor forcing the pooling concept and the use of multiple reinsurers.

MR. JOSEPH F. KOLODNEY*: Just to briefly respond to John Montgomery's comment, I've been on both sides of the aisle. I found that perhaps the most useful thing that the reinsurance industry has done in the last 15 years was to individually come to the conclusion, by company, that the AIDS risk was not an acceptable one without proper testing procedures. Gradually, over the last year or year-and-a-half, all of us who have any involvement with the underwriting process or corporate decision-making have been confronted with the reality that testing limits have come down.

I run a brokerage company, and we're very sensitive to our marketplace. Naturally, what our competition is doing has an influence on what we will do. The brokerage/general agency marketplace is a highly competitive one, and I was frankly very encouraged to see the major reinsurers and the secondary reinsurers come down from a quarter of a million to $200,000 to $150,000 to $100,000. As a matter of fact, we followed that and paced it in some respects. Now our underwriters tell me that we're picking up a higher quality of underwriting information on the basis of picking up drug usage, liver problems, a lot of stuff that you would not normally get if you had not tested at that level. I think that while AIDS is certainly going to be with us for God knows how long (at least another 20 to 25 years if not longer), I'm encouraged by the general position that the industry has taken in recognizing the problem and trying to deal with it.

If you look at the statistics coming out of the studies regarding who the most impacted groups are, you find that (if you're comfortable with that definition) the pure heterosexual population probably has the most diminutive risk of exposure. If you're testing at a realistic level, you very well may catch most of that. We find that people who think they have AIDS are not going to apply for life insurance, and you're going to get selected against by what you're not testing for. Even though our limit right now is $100,000, we see applications for $90,000-$95,000 and we ask for the blood test. Basically, I think that the industry is getting a fairly decent handle on the problem. We have to be concerned about the long-term liability involved in this, but I think that the compensating balance of getting a higher quality of medical information through the blood testing program is going to reap benefits for both the ceding companies and the reinsurers.

I'd like to make a comment if I might about one of the considerations in choosing a reinsurer. I've run into this situation on the primary side because we're pretty active in the immediate annuity marketplace. Any immediate annuity or structured settlement broker will tell you that price is not the consideration. It is a paramount consideration whether or not the reinsurer has a Best's rating. The Best's rating consideration evolves around a genuine concern for the purchaser as to where his money is going to be 20 years from now. So, I think that solvency has now become a major factor in the primary business in certain elements of product. I also think it's becoming more pervasive.

* Mr. Kolodney, not a member of the Society, is President of the Presidential Life Insurance Company in Nyack, New York.

I look at our reinsurers in the same light. There are some good companies. Smaller companies don't have the capital surplus structure that the larger ones do. I think there's a question as far as how much business we would feel comfortable in having exposed with them at any one time. Then you have the more major players, who hopefully have the capital structure to withstand the claims and have the surplus strength. So, I think that's a paramount consideration.

I think that's been a very dramatic change. In the business ten years ago, everybody was competing on almost the same level playing field. This aspect was not as consequential as it is today. You take failures like Baldwin United and Charter on the primary side; I don't think there's been a major reinsurance failure or, hopefully, even a minor one on the life side, although it's abundant in the property or casualty business. I think it's become a very critical issue now for people who are making reinsurance decisions to ask (as my old company did), "Do you know where your reinsurer's going to be in 1984?"

MR. ARDIAN C. GILL: I'd like to talk a little bit about AIDS and reinsurance. I think Joe Kolodney is a little too optimistic. It's true that the reinsurers and the direct writers are testing for AIDS, but that's only on new issues. In a sense, you're locking the barn after the horse has been stolen, and no one is looking into the problem of infection in your current inforce. There's nothing you can do about that except replacement. In the risk reinsurance we've seen lately, the reinsurers are still very aggressive on mortality for new issues, but they're waffling on guarantees.

My own prediction is that the reinsurer's defense is, after all, rate increases to the extent they haven't guaranteed the maximum. I think what you're going to see, in the short-term future, is a rise in risk premiums for reinsurance on the old business as well as on the new. As goes without saying, this shifts the risk right back to the direct writing company. You may feel that you're safely reinsured with the risk of AIDS and other risks, but you may not be.

MR. BIDELMAN: That's a good point. Are there any other comments?

MR. RONALD J. KNAPE*: I read recently, I believe it was in *Best's Review*, an article which encouraged tightening underwriting in the business in general. There was a management consultant, who is considered an industry expert, who was indirectly quoted in this article as saying that upwards of 95% of all new business being written today is being written on a nonprofitable basis. That's a pretty sweeping kind of statement, and I'm curious what kind of panel reactions there may be to it. It affects reinsurers and direct writers alike. Maybe to some extent it ties in with a number of Andy's rhetorical questions concerning practices about term pricing, conversions and so forth. I'd like to throw this out to the panel: How credible do you consider a number of 95%?

MR. BODINE: I guess I wonder how much further we can go competitively. I'd like to think that most of us have good sound judgment. We do our pricing, and we think there are margins. If we miss on one margin, we've got another one to cover it. Although I do have an overall concern about profitability, I don't know that I'd agree that 95% of all of our business is unprofitable. I've been concerned about articles saying that companies have gotten out of the

* Mr. Knape, not a member of the Society, is Vice President of Marketing at the Hudson Life Reassurance Corporation in Shelton, Connecticut.

universal life business because it's unprofitable. I would like to hope that this is not correct.

Incidentally, my comments are my own, not those of my company, but I think those who know me know that I am an advocate of the front-end load product, not the back-end load product. I think the back-end load product introduces another element of risk with which you have to deal with to a degree; it is not needed for the front-end load design. I think the industry today, for all products and not just universal life, is having a problem with the profitability of business.

I'll repeat a comment I made earlier. We have not recognized the need to reassess our sales goals with respect to the nature of the industry. I'm talking about the whole picture. We lost a lot of traditional inforce business because of replacements in the early 1980s. Those products were put on the books with a lot of nice profit margins and Linton A or Linton A/B persistency assumptions. It turned out that in the fifth or tenth year for these policies there were 40-50% lapse rates because they were being replaced by interest-sensitive products. I don't believe that companies have gone back and drastically changed any pricing or dividends on those older products due to these higher lapses. You take your lumps. You credit an artificially high interest rate to the new product, even though you didn't earn it when you only transferred the already invested assets, and then you go about your business as usual.

So we don't have margins from inforce policies as an adequate source of providing funding for new business. There are new products coming on the books that cost as much or more to put on than they used to. We're still living with high front-end commission rates, either in excess of 100% for a brokerage company or about 100% for a career-type agency (50-55% writing agent commission plus overrides bring the total up to near 100%). Then there are underwriting and administration acquisition costs and overhead costs on top of these commissions. I guess my premise (this reaches beyond the intended scope of this panel, but I thank you for giving me the opportunity -- it's my current "soapbox") is that this gives us the opportunity to see that we just can't support this new sales volume. We can't support selling at 20% of our inforce and growth at 15% of our inforce any more when our inforce, now mostly from the new business in the last five years, has very thin margins, if positive at all. Maybe they're okay by themselves, but they can't support desired levels of new growth. They were put on the books by funding with margins from older products then on the books. Think for a moment of shifting profitability goals, not to have a product breaking even in 20 years, but to have the product support new sales in the same way it was supported by prior sales.

Where I end up is that, unless we are willing to have agents see the necessity of noncommissionable front-end charges and first year fees so that a company's acquisition cost will be paid by itself and not from other existing business, the whole industry is in serious trouble. The only alternative is to completely levelize costs. I'm talking about levelized commissions, levelized acquisition expenses, and levelized operating expenses, which I don't believe can be achieved. A little bit of softening can be accomplished with commissions, but you're not going to get agents in general to go along with a flat commission scale. The only way to maintain or increase sales is to recognize the need for front-end charges so that a policy pays most of its own way when it is put on the books. After the insured pays the cost of acquisition and sees the charges up front, then renewal year costs can be much lower and more competitive in the

long run. The customer can persist at a lower renewal cost than he would have had with prior products, because he's not paying to put other products on the books. He's not paying for someone else's cost to the company when other policies drop off the books after only two or three years without repayment of acquisition costs. So that's my front-end load speech, and I thank you for the opportunity to give it to you.

MR. BIDELMAN: The only comment I would have is that Ron's statement might well be accurate if you take our current products and apply past experience. Putting AIDS aside for the moment, which of course you can't totally do, the persistency we've had as an industry in the last several years has obviously been horrendous because of replacement activity. In my mind, the biggest question mark involved in whether that statement's true or not is whether we will continue to stir up the marketplace to keep that kind of rollover activity going. If it does occur, I think the statement's probably true. If we have finally reached some steadiness in policyholder persistency, then I wouldn't agree with the statement. However, I don't know which side I'd fall out on at this point.

MR. STERN: I think my comments would be slightly different from Andy's because I'm a firm believer in the back-end load concept, probably just as much as he is in the front-load concept. I believe products can be priced on both sides to compensate the company for the acquisition of the business. I think the whole argument is for a different form.

MR. DAVID M. HOLLAND: In addition to my responsibilities with Munich American Re, I recently chaired the Society of Actuaries AIDS Task Force. My feeling is that insurance and reinsurance companies have not yet recognized the ultimate impact of AIDS on our industry. The reaction in the marketplace in terms of lowering testing limits has been necessary and proper, but that is not the complete solution to the problem. There are lives in our portfolios who are already Human Immunodeficiency Virus (HIV) positive, and some people we insure who are now HIV negative will become HIV positive. Thus, I see a real possibility for a significant deterioration in the mortality that we can expect, as both direct insurers and reinsurers.

As Ardian Gill indicated, reinsurers may to some extent be relying on the fact that reinsurance premiums are often not guaranteed, and in the worst situation there may be increases in the price of reinsurance. But my question deals with the relationship between the ceding company and the reinsurer. Should there be a change in the price the ceding company is charging the insured? For example, in the U.K., direct premiums on certain term insurances have in some instances more than doubled because of concern over AIDS. According to the traditional concept that the reinsurer follows the fortunes of the ceding company, if the ceding company increases the premiums to the insured, then the reinsurer should also have the opportunity to participate in that change. I would appreciate the panel's comments on the right of the reinsurer to participate in direct premium increases on reinsured business.

MR. BIDELMAN: I haven't thought about it that much. I would certainly support the desire that the reinsurer follow the increased price on the direct side. What else could a reinsurer say?

MR. BODINE: I guess I see it like the levelized commission situation. I see it as a commendable goal. I'd love to see it happen, but I'm not quite sure how to

get there from here. I'm not so sure where the companies that are going to lead us there will come from. Did something catastrophic happen in England, such as a major company going belly-up, to motivate the companies to do that kind of thing, Dave, or did it just happen?

MR. HOLLAND: The recent pricing changes in the UK were heavily influenced by changes in required reserves. The Institute of Actuaries AIDS Working Party has published two bulletins. The first, "*AIDS Bulletin No. 1*," sets out mortality tables A to F. Table F is the level of mortality which is expected under the most optimistic circumstances; in other words, AIDS mortality is expected to be at least as bad as Table F. Table A is a more conservative position; AIDS mortality may ultimately be as bad as Table A.

The Department of Industry and Trade is recommending that actuaries and insurance companies start setting up additional AIDS reserves on the basis of Table F. These reserves use the AIDS loaded mortality for calculating the present value of future death benefits (A_x) and the present value of future net premiums ($\ddot{a}_x$). However, the net premium used is the standard net premium without mortality loading for AIDS. This creates a substantial (deficiency) reserve even for inforce business. As of the year-end 1987, a significant number of companies in the UK had started to set up reserves at least heading toward Table F.

If you were to look at a 20-year term product, on the basis of Table F, the extra reserves per thousand at age 35 could be roughly $7.00 per thousand. Using Table A, the additional reserves could be as much as $22.00 per thousand. Thus, they are talking about some extremely significant increases in reserves as a result of AIDS.

There has not yet been that level of reserve strain for AIDS within the US. US valuation actuaries have the responsibility to certify that the reserves make good and sufficient provision for future unmatured obligations, and the requirements of professional practice from the Academy indicate that, if there is reason for concern about the adequacy of the statutory valuation, additional tests should be made. Here, the Academy recommendation calls for a gross premium valuation.

I hope that actuaries will start looking at the impact of AIDS using some of the modeling tools that our task force made available, to see what level of additional reserves may be required. Once management starts seeing that they have to put up substantial additional reserves for AIDS, they will start taking the cost of AIDS more seriously in pricing and other analyses.