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SINGLE PREMIUM LIFE AND ANNUITY PRODUCTS

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- o Market developments
  - -- General account products
  - -- Variable products
- o Federal income tax outlook
- o Investment strategy/crediting strategy
- o Pricing considerations
- o Valuation, nonforfeiture and state filing considerations

MR. MICHAEL WINTERFIELD: My comments will focus on two broad areas. The first is the customer base and the multiple distribution networks for these products. I hope to show that the single premium products represent an ideal fit for both the customer and the distributor. My second area is a little more difficult. I would like to discuss some of the problems and challenges to insurance companies in setting sufficiently competitive rates for the single premium general account based products. My basic feeling here is that companies who want to effectively compete in this market will have to do two things. First, they will have to establish a consistent interest-crediting strategy for both the first policy year and for the renewal policy years. Second, there is a need to establish a balanced investment policy which will keep the C-1, C-3 and other investment risks within prudent limits. We recognize right up front that many companies may in fact determine that the prudent standard simply cannot be met.

We will talk about single premium life insurance, single premium deferred annuities, single premium variable life insurance, and variable annuities, representing a convergence of consumer and traditional/nontraditional distributor needs.

There are many driving forces behind each of these four products. In the case of single premium life, we are looking at highly favorable publicity, a very attractive package of insurance, competitive interest rates, and tax efficient distributions. The issue process has been very cumbersome in many of the areas, especially within the brokerage community, but it is being addressed very satisfactorily with simplified higher nonmedical limit programs and express issue. The second-to-die approach is also pertinent here. I believe that Ms. Guinn will be covering that a little bit later.

In the case of the Single Premium Deferred Annuity (SPDA), we are dealing with the absolute ultimate in simplicity. In the case of some of the bank distribution methods, we are looking at an immediate issue where the client can sign an application, tear it off, and go home with his or her contract already there. There is a tremendous instant appeal to the entire certificate of deposit base.

In the case of variable annuities and single premium variable life insurance, there is a very natural affinity with the mutual funds. Last year, the mutual fund industry produced over $210 billion of new sales. A very important factor here under tax reform is the loss of the 60% capital gains tax exclusion -- which adds a lot more luster to the variable products. We have all heard a lot about the creative accounts: asset allocation or managed-type accounts, global accounts, aggressive stock accounts. Also, we have now seen many "wraparound" name funds. A few examples are Fidelity, Oppenheimer, Paine Webber, and Shearson funds.

Let's move on to the distribution drivers. These products are tremendously exciting for all of the distribution channels. We start off with the agents who have the necessary expertise with the four products combined. We are looking at an array of products that can cover all bases for people who have $5,000 or more to contribute. These products can appeal to a range of both risk-averse and risk-taking clients within the mid and upscale markets.

In the case of the stockbrokers there are the very favorable comparisons with the mutual fund and other investment products that they have been selling. The management of most of the brokerage houses, national and regional, are really pushing these products this year. Another very favorable development

here has been the advent of trail compensation where asset based compensation is added to attractive upfront marketing allowances for the firms.

Let's switch over to the banks. These products compare very favorably with CDs. From the standpoint of the bank management, there are often opportunities to get 400 to 500 points as an upfront marketing allowance as opposed to settling for 50 to 75 points per year on CDs. There is a perception that deregulation is coming -- which will be very helpful to the banks. The sales here have been for the most part single premium deferred annuities, but the expectation is that single premium life insurance will also be coming on strong as the banks get a little further along on the learning curve. We haven't seen any really great successes in direct marketing yet, but I believe that they are also coming. The big need here is to have the right sponsoring organization. The question is whether Fidelity will be the one to lead the way. From Mr. Rohda's comments earlier, that certainly might be the case.

As an example of the dynamic growth of the single premium products within the stockbroker community, I have some statistics on the single premium commissions of four of the major national brokerage houses. (Merrill Lynch, the leader, is not one of these four.) We are looking at commissions which grew from $31 million in 1985, $49 million in 1986, to $70 million in 1987. In broker's language, these commissions would represent an average of 4% to 5% of premium. You can arrive at the premium figures by multiplying by a factor of 20 to 25; so the 1987 premium figure for these four national houses would be in the $1.5 billion range.

In the case of single premium life insurance and single premium universal life, we are looking at a build-up from $1.4 billion to $5 billion this year. Single premium variable life insurance is projected to grow from $.5 billion in 1985 to about $3.5 billion this year. That number could perhaps drop a bit with the recently low Dow in mind, but still it is going to be a very, very favorable number. The SPDA numbers, which involved a lot of estimating, show growth from $6 billion in 1985 to $7.2 billion in 1987.

Lastly, I included within the variable annuity and combination fixed/variable annuity area only the estimate of nonqualified annuity premiums -- which are more of a single premium nature than a periodic payment nature. In Exhibit 1

we are looking at estimates from $2 billion in 1985 to $3.3 billion in 1987. All of this adds up to close to $10 billion in 1985 and an estimate of $19 billion for 1987.

EXHIBIT 1
Estimated Premium ($ Billion)

	1985	1986	1987
Single Premium Life/Other	1.4	2.7	5.0
Single Premium Variable Life Insurance	0.5	1.4	3.5
Single Premium Deferred Annuities	6.0	6.5	7.2
Flexible Fixed/Variable* Annuities (Nonqualified)	2.0	2.5	3.3
	9.9	13.1	19.0

*Approximately 2/3 Fixed

I would now like to switch over to the second area of discussion -- which will cover the challenges in setting interest rates and the associated investment strategies: July 15, 1986, which was pretty representative of 1986 as a whole; exactly one year later, July 15, 1987; and then an update in the rising interest market on October 6, 1987.

In 1986, looking at 16 top companies in this market, there was an average new issue rate of 7.95% versus an average 6.96% rate on five to seven-year treasuries (which I decided to use as an example of the underlying investment maturity that a number of companies might work with). In July 1987, we are looking at the average new issue rate of 7.97% as being virtually a full percentage point over the five to seven-year treasuries -- obviously indicating a very, very difficult pricing environment. Look a year later at 19 top companies in the market -- some different and some the same. We find that the five to seven-year treasury rates had climbed over 100 points to 8.10% but the average new issue rate had hardly budged. At the beginning of October, the five to seven-year treasuries went up another 136 points and the average new issue rate of 8.24% responded to the tune of 27 points.

The changes in 1987 would seem to indicate that there is a little more rationality in the pricing environment. At the same time, we have to recognize that companies have not had a full opportunity to catch up to the rising interest rates, so we have to temper a little bit of the good news here.

Again, I would like to tie into the July 15, 1986 information and note a very significant area of concern. This is the renewal rate practices of various

companies. I tracked the same 16 companies and found that their average second year credited rate was 7.55%, representing a 40-point drop in the face of a 110-point treasury rise. Summarizing the renewals, we found that four of the 16 companies maintained the same rate as they had initially. The other 12 dropped anywhere from 5 basis points to 125 points. I think that this is one indication of the difficulties that companies have had in setting initial rates. In many cases, they simply were not sustainable over the long haul or even the short haul.

Let's take a look now at some of the investment decisions and the various risk and yield trade-offs. There are questions regarding the choice of investment vehicles: public or private, investment or noninvestment grade, and getting into other areas like real estate. The concern here is with the default and volatility risks. Obviously, we have the whole C-3 risk to deal with, the choice of maturities, and the questions regarding the tradeoffs between higher yields and the loss of principal. Can a balance be found?

Exhibit 2 shows available interest rates on October 13, 1987, to give you an idea of some of the pressures we are dealing with. Treasuries were ranging from 9.45% for five-year instruments to 9.88% for ten years. If a company went into the public A market, there was a pick-up of 60 to 80 points; private Baa's afforded a pick up of 130 to 175 over the treasuries. Commercial mortgages with prepayment protection were running a little bit under the privates.

EXHIBIT 2
10/13 Investment Alternatives

	5 Year	7 Year	10 Year
Treasuries	9.45%	9.74%	9.88%
Public - A	10.05	10.34	10.68
Private - Baa 2	10.75	11.04	11.63
Commercial Mortgage	10.69	11.12	11.24
High-Yield (No equity)	----------12-13%---------- Default Adjusted		
High-Yield (Leveraged buyout with equity)	----------15-25%?---------		
Equity Real Estate	----------11-14%----------		

A very important point here is that except for some highly unusual times (like the last few weeks where the company rates have not caught up to the rise in the marketplace rates), companies simply cannot calculate reasonably competitive rates by working with the more conventional instruments within the shorter range of maturities (like five to seven-years).

Something else has to be done. We can move out further with the maturities to more like ten years or we can move down into the quality risk. High yield bonds on a historical default adjusted basis (taking off perhaps 150 points after allowing for salvage value) had a possible expectation of 12% to 13%. Another different example would be equity real estate. Some companies are touting real estate as being capable of producing say 11% to 14% rates over a seven-year to ten-year type holding period, but there are many problems here. For example, the initial cash on cash rates would be in the neighborhood of 6.5% to 9% and this would be before depreciation which would affect both statutory and GAAP earnings, so it is not a very easy environment to deal with.

As an example of the maturity risks that companies have to deal with, I wanted to cite some sample runs. The numbers are based on some lapse rates that might not be totally up-to-date, but they give you an example of the kind of study that is necessary. In these runs, when we looked at five to seven year maturities (with a single premium product with a typical termination charge pattern of 6% to 7% grading down over seven or eight years), we found that there was an ability to break even on the initial investment in the contract even if the marketplace rates rose by as much as 5% to 6% for the first two years. A higher rate of increase would have caused a bustout.

If the company worked with somewhat shorter maturities (three to five years), the protection level was considerably higher. Up to an 8%-9% rise over three years could be tolerated, but of course the underlying rates would be a lot lower.

I would also like to note that when companies do their modeling work, it is important to distinguish between the SPDA investment anti-selection dynamics and the single premium life dynamics. We feel that in some ways, the single premium life contract can provide an additional level of protection. Some of the things we would cite here at that if clients wanted to transfer to another

carrier, they will have to meet new underwriting requirements. A client would also have to forfeit any unused wash loan capacity on account growth, and if a wash loan has been exercised, the client will have to repay the loan on the old contract to make the full transfer.

MR. PAUL LEFEVRE: Keystone Provident Life in 1980 had essentially a 100% market share in the single premium whole life marketplace. Now we are sharing it with everybody and I guess we are down to under 5%. One of the things I wanted to talk about is the single premium whole life product that we issued from 1979-1983 and the product that we issued in 1983 which had a bailout on it. In essence, the renewal rates have all dropped below the bailout level and I thought it might be interesting to see what kind of surrender experience we had, and how much the bailout might have cost us. I am going to go through some of those numbers with you and you can draw your own conclusions.

The original single premium whole life that we sold was a product that got a lot of industry concern. It was a product with a very low death benefit. When we sold that product from 1981 to 1983, it had a 100-basis point bailout. Basically, there was a letter (it was not in the contract itself) that went with the contract and stated that if we ever dropped the rate more than 100 basis points or dropped it to a level 100 basis points below the initial rate, they would have a 90-day period for which they could surrender the contract for the accumulation of the single premium at whatever declared rates had been in effect adjusted for policy loans. We decided on 90 days because it was long enough to have them decide to keep it. If you told someone that they had 30 days, they might panic and say they have to get out. We felt the psychology was to have a long enough period for people to realize that it was stupid to get out, if in fact it was. That product had an initial one-year rate guarantee. After that point, the rate was allowed to be changed at any time; it just floated. It also gave us a product where the administration and the controlling of the bailout were a lot easier because we could take a block of business and change the rate on a given day, as opposed to the anniversary. We could send out a single notice. We could run the 90-day period for large blocks of business without worrying about anniversaries and crossing.

Another important thing is that this bailout and all of the other bailouts we had on our product did not renew in any way. Once the bailout was breached, the

bailout feature was gone forever. It did not renew for another 100-basis point drop. The first bailout breach that we had was in early 1986. It was a tough one because at that time we were dealing with an outside wholesaler and essentially everybody was afraid. Even though the rate differential between new money rates and the rate we would have lowered to was quite large, people were afraid. I remember our chairman got a letter from our distributor saying that not only will he never sell a single premium whole life product, but he will never sell a mutual fund again, and we are owned by a mutual fund company. So it was this great big prophet of doom. We were going to be out of the marketplace forever if we breached a bailout, but we did it anyway. In that one we were very cautious. What we did was we sent the letter to all of our major houses that sell our product, warning them that we were going to do it. The policyholders got a notice that said that this rate change was inactivating the interest protection feature of their policy and that the rate that they had was quite attractive. It in no way indicated that the company was in trouble or anything like that. It covered a very large block of 31,033 policies.

The history of those policies was that they had been sold at 13.1%. We had become cautious about breaching the bailout. The first drop we took was down to 12.25% where we hung around for quite a while, and then we took it right down to the level above the bailout at 12.10%. We had to break under the 12.10% to breach it. Finally in November, 1986 we went to 11.50%. At that time, our current new money rate on the successor product (it was not the same product) was 7.34%. We felt it was rather foolish for people to give up 11.5% to go to 7.34%. Many people agreed with us; all but 26 agreed with us. We were quite happy to only have 26 bailout surrenders on that block. After that we got a little less worried about bailout breaches and decided it was a good time to get rid of the risk. We have tabulated the results of bailout breaches of this single product on 10,548 policies.

As the years progressed and interest rates kept coming down, we did end up breaching bailouts on some blocks where the differential between the new money rate and the renewal rate on these products was quite small. We tabulated this in order. In general, the lower the rate differential, the higher the surrender percentage. It still was not a wild run on the bank. The $762,000 is the amount in excess of what we paid out on all of these surrenders over what we would have paid out if they had been ordinary surrenders. It is just the

amount of penalty that was forgiven, which in a sense, in pricing a product with a bailout, is something that you have to account for if you are going to breach the bailout. Somewhere down the line you are going to give people more money than you have in your pricing runs if you ignore that. I did not attempt to approximate an offset to that by trying to estimate what I would call a capital gain equivalent. When these people left, we kept the investments that were earning more than new money investments and got rid of the liability on which we were paying a higher rate. So in essence, that was an offset to this number that makes the cost less.

When we looked at this material, I tried to see if there was any other thing that stood out. As we looked at the policies, we saw that if we looked at the percent surrendered as a number of policies versus units, then the percent surrendered on the entire block for example was 1.79%; if you did it in units, it was 1.763%. The indication there is that there was a skew toward larger policies in the surrender. The average size of the surrendered policies was larger than the average size of the whole block. We looked at loans, but there did not seem to be any correlation between borrowed or unborrowed policies. We tried to do a little bit of looking at agencies but nothing really stood out. Our initial fear which I alluded to was the stockbrokers. All of us that have business that is written by stockbrokers have an essential fear because we are dealing with people who are used to managing people's money. They are also used to making commission dollars on the same money. We found that the surrenders we did have, did manifest that in talking to policyholders. Why are you leaving? "Well, my broker says this is a once-in-a-lifetime opportunity to get out without a penalty." You would say, "Didn't your broker put you into it?" The policyholder would respond, "Yes my broker found some 1035 activity, but it didn't really manifest itself."

Let me just quickly go through some of the other products. After this product we stopped having bailouts in a life product. We were very cautious once 101(f) came out, and once the 7702 came out, with the potential effect of a bailout on compliance, especially with the type of products we have. So we stopped doing bailouts in single premium whole life. This product was issued over a one-year period. It was a product with an initial three-year rate guarantee. At the end of the three years it had a 100-basis point bailout, very similar to the previous one, except that this one was in the contract. It wasn't an anniversary based

rate change, so, in this case we were dealing with blocks of business, some of which spanned maybe three months of issues. Once we set the rate, it became known at least to the agents who were watching that we were giving some people a head start on knowing that the bailout was going to be breached. The information that was sent out to the policyholder was sent out with his anniversary report, so that is when the policyholder officially found out from us that he had a 90-day period.

In 1983-1984, we sold an SPDA product -- a product that had a 5% penalty for five years, that had a 100-basis point bailout, 90-day period, with the same type of wording. We did not allow partial bailouts. People would call up and say we had breached the bailout, and ask if they could take out half their money without a penalty; and we said, no. You like it or you don't like it and it can't happen. So we did not forgive penalties for partial surrenders during the period, only full surrenders. In the case of this product we can look at the tabulated results. We did breach bailouts in 12,400 policies. This is an element of correlation as the rate drops. You don't see too many very large percentages and, again, we are out almost $200,000.

On the annuity, there were some interesting side things that happened. And there were some things we had to time because, at least in our opinion, once the bailout was gone, the Commissioners Reserve Valuation Method (CRVM) reserve changed and the tax reserve changed. So there were some tax considerations in when we would breach the bailout in the different tax rates applied to company income over this period of time. So what you would have is a situation where when you breach the bailout, your reserve would drop down to a reserve that does take the penalty into account and then a few years later when the penalty wears off, the reserve goes back up. So those types of things do affect taxes and I won't say anymore about that.

The last topic of conversation is a block of SPDAs that we issued from 1984 through 1987 with the same bailout provision. But at that time we were starting to write an awful lot of business and we didn't like the surplus strain from the bailout. And, of course, our marketers said we couldn't sell, without a bailout, and we thought we could. So, we decided to let the market decide. What we did at that time was introduce three SPDAs. They were identical products, but we offered them with three choices.

One we called stripped and naked -- it had no interest protection. We called that the Trust Me policy. We said we will give you a rate each year and whatever it is we are sure you will love it.

The second one we indexed to T-bills. It was not an indexed rate renewal, or an index floor. It was indexed to a running average of T-bills. We did not index to the T-bill rate at the time of renewal. What we did was we would take, for example, at the first renewal the index based on two-thirds times the T-bill rate at the time they bought it, and one-third times the T-bill rate at renewal. In the next year it was two-thirds of what the index was the previous year, one-third of the current rate. We called it a dampened index, but provided the person with the idea that they were not investing short term. If rates went up, it followed rates up; if rates went down, it followed rates down. And we also offered a good bailout. Most of the time the product was offered the rate differential was 25 basis points to the index, and then we went down to 75 basis points for the bailout. So if the person wanted the bailout it cost them on their initial rate 75 basis points.

The other thing we have done on this business is we have breached bailout. It is quite an interesting thing when you have these two products -- one without a bailout and one with a bailout -- and you breach the bailout on the business with the bailout. All of a sudden the products become prospectively equivalent. And a person could say, "Now I have the same product as the other person but you are paying me less." So, we have instituted a practice on the next renewal after we breach the bailout to bring the rates back together -- either to increase the bailout rate to the level of the renewal rate of the nonbailout product or decrease it less, or whatever, to equalize it.

I think most of you are aware that Congressman Stark is having a lot of fun. He had a little less fun in October 1987. He introduced legislation that was aimed at equating distribution treatment for life products with annuities. Those of you that saw that realize that it included such things as loans being treated as distributions and being taxable on a LIFO basis, just like annuities, and it included penalty taxes of 10% if distributions occurred under age 59 1/2. There was a grandfathering in that submission that was somewhat confusing, but our interpretation was that existing contracts were grandfathered to the extent of their cost basis. There were some confusing things about loans being

renegotiated or being renewed creating new loans. There were a lot of things in there that were not clear. That legislation was withdrawn because officially it was too complicated. But I think the politics got a little heavy for Congressman Stark.

It seems fairly clear that the attack on single premium whole life is due to the advertising and the articles which we see -- the product of the year, the last remaining tax shelter -- all this type of advertising has sort of spit in the face of Congress. The major thrust seems to be to go at the problem through distribution routes. There are industry groups, agents' groups, the National Association of Life Underwriters (NALU), who are coming at the problem as you might expect. They are trying to get at it where they can save a lot of things at the expense of single premium whole life. That is my personal comment and not the official comment of NALU. There are some proposals that are interesting coming from that direction. They are working mostly through the Senate. There are committees of interested companies lobbying, working in the other direction. We will see what happens.

I have a question. There was a comment by Mike about how much easier it is to move an annuity than a single premium whole life product. One of the things we found and one of the things we are getting concerned about is, in general we have seen a lot of 1035 activity in our company that goes from life to annuity. You can't just assume that once a person has bought a single premium whole life product -- if you look at the motivation for buying it -- that they are going to stay with that product. If the Congress is successful or if something comes out of Washington that removes the distribution advantage from the single premium whole life product -- the ability to get at your money without taxation -- we suspect that the rate differential between an annuity and a single premium whole life product might be too large in the eyes of some of the public who buy it to justify the advantage they get over an annuity. A properly priced annuity versus a properly priced single premium whole life product needs at least a 100 or 125-basis point differential. That differential may be too much for just getting the death benefit proceeds distributed tax-free. So we suspect that there could be some movement from life to annuity or that things will have to be done in the product development area to narrow that spread.

MR. DAVID M. MORDORSKI: The data you showed was obviously all during a period of rather dramatically declining interest rates. With the interest rates having turned around earlier this year, I wonder if anybody on the panel or in the audience has any information on withdrawal rates on these types of products during periods of increasing interest rates.

MR. LEFEVRE: I don't have any specific information. We started selling single premium whole life in 1979. We went through the rising interest rates, we took rates up slightly during that period. At the time we were paying 13.1% on new money on single premium whole life, and we had blocks out there that were getting credited 9% and 10%. In general, in the life products you have to look at loans as well as surrenders. You have to look at the combination. My recollection is that we saw certain blocks where there were large, what I will call liquidation rates including loans, approaching 6%-7%. When those rate differentials went to 300 basis points, we did not have an appreciable, what I will call, run on the bank. On the way down, of course, after we peaked out in about 1982, total decrements including death on this business year-to-year were running in the 1% to 2% range.

MR. MORDORSKI: I think I heard you right -- you are saying decrements in the 6%-7% range. I just came back from a Valuation Actuaries Symposium where people were saying that to qualify under New York Regulation 126 your model ought to be producing lapse rates of 50% or 60% when you get wide interest differentials. Mr. Callahan implied that was almost a requirement; that your model must demonstrate those kinds of lapse rates. That is quite contrary to what I hear you saying.

MR. LEFEVRE: There were extenuating circumstances. The product we were dealing with had become grandfathered by the tax laws. We have had a lot of discussions, we have done some models, we have talked to people who do models, and I personally feel that we were dealing with the public. As an example, I decided on Monday of this week that I was going to move my money out of the Magellan Fund. I forgot to do that. Many of you are involved in fringe benefits for 401(k) plans, savings plans. Many of you work for companies that administer these plans. These plans have various choices of where the money can be. I ask you, how often do you move? How often, with your knowledge, do you sit down and say, this is what you should be doing and then do it? I

think the key to the way this business behaves is based on the understanding of a large group of people of the options that they bought and then the inertia to act on these options. I think it is going to increase. But I would be amazed if you had, and I have seen models, a 400-basis point differential in rates, and half the people walked out in the next few months. We haven't seen it.

I'll give you another example -- a fixed account variable annuity. It scares the living daylights out of me. We've got one. I argued, I tried to put safeguards on it. People put money into a fixed account, a guaranteed principal account. They could play it against a bond account; they could play it against the stock-market; they could play against the money market. It just sits there. One-third of the variable annuity policyholders during the whole bull market stayed in the money market. I am not trying to say what is being done is wrong -- you have to look at the dynamics; but some of these models even say, that if you have a 400-basis point differential, you are going to lose half the people. The next year you are going to lose half the remainder, etc. That doesn't make sense psychologically.

MS. DONNA R. CLAIRE: I was one of those at the Valuation Actuaries Symposium telling you about the 40%-60%. The reason being that at that time I was working for a debit company, which was actually what I would call lower to middle range people, and we experienced lapse rates in the 40%-60% range. We did sort of an unscientific survey at the meeting and determined that the 40%-60% was in line with what a lot of the major companies were getting in the early 1980s when you were about 500 basis points off. Another point is I agree a lot of people don't move that quickly. But how many of you still have your 15% mortgages around? This is just the opposite side of the picture. The consumers are getting better educated and we are afraid and we have seen that the bigger the rate differential -- they won't move to a little one -- the more people will get up and walk out.

MR. WINTERFIELD: I would like to supplement the last few comments. I think, as Donna said, the real key is the size of the rate hike. If this is for a contract in the first, second, or third year (when you have a 6%-7% termination charge and rates go up by 1%-2%), few people will leave because they are looking at a 4-5-year period to recover the surrender charge. When the rate hikes get up to 400-500 points, especially when the termination charges are

wearing off, is when you get into the "crunch" time. If single premium life rates on new issues a year from now were at 12% and 13%, many of the people who have bought today at in the 7% and 8% will run.

MR. JOHN A. HARTNEDY: Somebody mentioned Anchor. I have not studied the experience there, but in the early 1980s I was the actuary for National Investors Life Insurance Company. Some of you may remember that name -- past tense. The lapse rates we had on an SPDA at that time, and I am grabbing by recollection here, Paul, but I think I am right -- were about 15 1/2%. That was the rate National Investors was paying on the SPDAs in 1981 and a little over the quarter of a year we wrote about a billion dollars worth of business. Our marketing arm was PLANCO, which sold strictly to stockbrokers. I mention that as background because I still feel that is important. We had about $200 million on the books prior to that and that was lapsing off at a rate, if I recall correctly, annualized nearly 50%. Now, did we actually lose $100 million? I can't honestly recall but I think we came pretty close to not just an annualized rate but in fact, we lost about $100 million. To be quite honest, the impact among people within the company was almost negligible because of the tremendous volume we were writing. But again, we were paying at the time close to, 15 1/4% and some of that $200 million in business, although it was recent, was probably an average age of less than 12 months old. But the rate differential was very significant. Some of that was older than 12 months; actually 8%-9% when it rolled out.

MR. LEFEVRE: What I was talking about was single premium whole life, not the annuity. We did not have annuities at that time. At the time this was going on, the product was becoming grandfathered. On the newer products you needed to reunderwrite the things that Mike talked about, so I would say our experience on that product was very much affected by the fact it was not an annuity. That is extremely important -- it was not an annuity experience I was talking about.

MS. PATRICIA L. GUINN: Another product that Mike brought up was second-to-die product. The comment has been made that the interest differential between the single premium whole life policy and an SPDA is not well understood or appreciated by the consumer. Second-to-die products are an attempt to squeeze that differential. There are maybe three or four products I know of

being sold now and a few others under development. Some numbers I have seen indicate that the cost of death benefits, let's say for equivalent underwriting, can be cut somewhere between 30-50 basis points. If you use some of that to expand your nonmedical limits or to simplify your issue process, you still have 25-35 basis points so you can cut that differential between single premium whole life and SPDA.

MR. LEFEVRE: Do you have any fixed second-to-die products? I have seen it only on the variable.

MS. GUINN: I believe there are fixed products. There is a marketing outfit on the West Coast -- the Regan Group -- that is selling a fixed product.

MR. JOHN W. H. TAYLOR: Tricia, on your second-to-die product, it sounds good that we are eliminating or reducing the cost of the death benefit by this method. I know that is market desire. But does the insurance company get hit like it did on the old fixed cost second-to-die product at the point in time that the first insured dies?

MS. GUINN: There are two methods for dealing with cash values for nonforfeiture and valuation compliance for these products. One is the more traditional method where on the first death you give some benefits. The actuarial mechanics are that while both people are alive you use commutation functions that assume both people are alive. But when the first death occurs, from that point on you use single life functions. So that causes a big increase in cash values when the first death occurs. That method is pretty complicated for the single premium kind of product.

A second method which was described in an article in *The Actuary*, 1978, by William Fraser. It is called the Fraser Method where he defines a system of defining the second-to-die status as a status and then calculates smooth values throughout the period; there is no jump in cash values or benefit on the first death. To my knowledge you can get products approved in over 40 states on that basis, California being one.

MR. LEFEVRE: I know that when Philadelphia Life brought out that product, it did not sell well nor was it well known, but it was approved in 42 states in

1976. But a lot of the state actuaries feel very strong about Jordan and have given techniques and gave it some trouble.

The second concept that Mike addressed is the whole question of variable universal life products, in a single premium mode. I know our marketing force tells me that an organization with 2,500 brokers who are financial planning-type people, used to selling mutual funds, etc., have a lot of trouble selling the variable universal life. I was wondering, Mike, have you seen that from the marketing side?

MR. WINTERFIELD: No, I think there is basically a very, very lively market both for the fixed products and for the variable products. Today (looking at the Dow Jones) would be a very difficult day to sell a single premium variable life product. But I think with the different types of accounts we have now, these contracts bring the risks down to a much more tolerable level. Rod Bohda in the variable products session talked about new accounts that simply do not involve the same kind of risks when you are now dealing with aggressively managed accounts, asset allocation and accounts, where the mix of stocks, bonds, and money market instruments tend to vary. But I agree there will be many people who simply will not touch a product that is not guaranteed.

MR. PHILIP K. POLKINGHORN: I just wanted to make a comment on the last-to-die product. I am aware of a product, using what Tricia described as smooth cash values, that was filed and approved in the last 12 months in 48 states and the District of Columbia. The company is not licensed in New York so it was not approved in New York and I can't remember what the one other state was.

MS. GUINN: It might have been Mississippi.

MR. POLKINGHORN: I don't think it was Mississippi or Alabama, where there historically have been problems. It used to be if you had problems in one, you had problems in the other.

MR. PAUL J. STRONG: Could I ask someone to comment on whether they feel second-to-die has any problem qualifying with the tax code? And, if not, where do you draw the line in terms of going to fourth-to-die, eighth-to-die, twelfth-to-die? Or, do you feel it is an abuse?

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MS. GUINN: The tax questions surrounding it are pretty major and getting a satisfactory answer to that is paramount to getting the product to market. A lot probably has to do with how your guaranteed mortality charges are calculated and doing something there that is defensible. The last method that makes some sense is constructing the last-to-die mortality rates using CSO basic mortality and then putting the loading back in at the end; this gives you more of what you want in terms of premium/death benefit ratios but still gives you a set of cost of insurance rates that you can say make sense. Twelfth-to-die? I don't know if I would try it.

MR. JAMES F. REISKYTL: Regarding the tax scene, unless something happened yesterday, I believe what you said wasn't quite accurate. It is true that Stark's bill is not part of the current tax bills, but my understanding is he has not withdrawn his bill. He intends to use it as leverage to lobby with the industry to have an effect on single premium life.

MR. LEFEVRE: The House Ways and Means Committee is unanimously opposed to the product and they intend to close down single premium life. How they will do that is yet unknown but there is agreement and we understand that something should be done. There probably is agreement that what Stark has proposed is not the way to do it. What will evolve in the next few months or years? Who knows how this process goes? But at least the smoke is there; not that that is any surprise to the industry.

MR. REISKYTL: The area of abuse is a tough one to deal with. I think we are well aware of single premium products that are using very high contractual expense charges and very high mortality charges to beat the definition. That is probably going to be a problem for the actuarial profession in some way, although we can't be the keeper of everything. But it is going to be an ongoing problem. Twelfth-to-die probably would fall in that category.

How important is the distribution function in the single premium life as an investment? This is where we start dealing with the situation. Does it matter that you can't draw on your money for x years? What if that were prohibited or taxed for last in/first out for x years with a penalty? I would like an opinion on how long a period it would have to be to have any impact on sales.

Is your investment strategy for single premium life comparable to that of single premium annuity, or are there differences? You mentioned various contingencies. I would like to have some opinions of that.

MR. WINTERFIELD: I will take one shot at the change in the marketing of the product. I think the majority of individuals who are buying single premium life insurance are interested at some point in time in exercising the distribution right -- and having some potential to get them tax-free is very important. I think we are looking at loan rates which will increase very much over time. Most of us haven't seen particularly high loan rates in the first 2-3 years. Many people who are buying are looking forward to taking loans out after 5-10 years, 15 years, or whenever they reach a retirement age.

With that in mind, I think the distribution side is tightened up. I would see many people not purchasing single premium life insurance, but probably in many of these cases switching over to an SPDA, which would still be perceived as having some advantage. I would agree with comments that Paul had made earlier in that area.

MR. LEFEVRE: We feel maybe about 20% of our single premium whole life customers are buying the product with the express idea that they are going to take annual loan distributions or take advantage of the so-called "take your income out tax-free-type approach." The question that alludes to what you are saying is, in addition to those people, how many people find the product attractive because they know they can get at their money? I don't know what that is. There is a lesson from the annuity side because through TEFRA the first thing that happened with the annuity is they changed the whole distribution tax. They went from FIFO to LIFO; they introduced penalties, taxes, etc.; then they closed up the generation skipping and the ability to control distribution on death. We are going to sell more than $400 million in annuities this year. When the product has been basically stripped of most of its tax benefits, when the annuity and the life product come closer together, the question is, do people want the death benefit and are they willing to pay for it?

On the investment question, my answer is, yes. I think if you look at the characteristics of the product and the characteristics of the buyer age-wise, etc., yes, there is probably an argument for a different liability matching-type

structure. In other words, you would expect different durations on the liability side and different sensitivities. I think the annuity is hotter money.

MR. LAWRENCE M. AGIN: I have a question on the compensation side of things, particularly special issues like New York or where you have special versions for stockbrokers versus life insurance agents. Does anyone have an answer to that?

MR. LEFEVRE: Yes, we have different compensation schemes, if you will. In general, some of them are related to the amount of service we provide that field. There are certain stockbroker firms that do all their own distribution. They do their own sales material, etc. They get a higher commission than one that utilizes wholesalers, our sales force, our wholesaling force, our sales materials, etc. The fundamental difference between the way you might compensate to a financial institution, a banker, a savings and loan versus a stockbroker is you design the product for the market and you design the compensation for the market.

MR. WINTERFIELD: We generally have seen the total marketing allowances running very similarly at companies who use both agents and stockbrokers for distribution. The individual components obviously are different, but a lot of care is taken to keep the two totals comparable. The one area in which we have seen somewhat different compensation patterns has been within the banks. One factor there is that an average bank sale runs a lot lower average premium, about $15,000, as compared to sales in other channels. In many cases, this has led to somewhat higher compensation patterns within the bank distribution area with, at least in theory, some matching adjustment on the policyholder side -- with an expectation of modestly lower interest rates over a period of time.

One other movement I would comment on is that we are seeing some differences between the fixed product and the variable product compensation structure -- often at the same company -- to recognize the greater difficulty that a sales representative or stockbroker will have in presenting the more complex variable product with 5, 10, or 20 different options. Companies are in many cases allowing a little more compensation on the variable side. Many times it shows up through the trail compensation (the asset based compensation I mentioned earlier).

MR. POLKINGHORN: Do you have special products for New York relative to compensation?

MR. LEFEVRE: As far as I know, the asset base compensation is something you cannot work through New York right now.

MR. POLKINGHORN: I would like to make a comment on Paul Strong's concern on the last-to-die and 7702 that draws in a little of the comments that Jim Reiskytl had. I think we may see some people who are pretty aggressive 7702-wise on last-to-die for the following reasons:

1. I think they will agree with Jim that if the product is addressed, it is going to be addressed in a blanket form. If Stark goes after single premium life, it is not going to just be last-to-die; it is not going to be just products with higher than average cost of insurance charges. It is going to be the generic product type.

2. There probably isn't a major law firm that would give you a clean opinion on the last-to-die product no matter what you do. So you are not going to get a clean opinion anyway.

3. They feel the window is short. I think we may see some moderately aggressive positions 7702-wise. I think Paul's concern is legitimate.

MR. LEFEVRE: Yes, again, I will throw out my personal opinion: When you create something -- the guideline premium test -- and don't issue regulations, it is a challenge. We know which companies are aggressive and which ones are careful, and I think we can take all the blame in the industry, that was a pretty bad piece of legislation. They could have gone at it pretty directly. Instead, we go in there with undefined items, like future charges and the lack of consistency in some of the mortality stuff and no regulations come out. Certainly aggressive marketing organizations, and we all have seen it, are going to take what they can. All of us that spent time in Washington saw the government come out with a 1400-page simplification of the tax law -- there are easy answers, easy ways to do things that might not be actuarially fancy. Explain guideline single premiums to a congressman. It really calls up abuse.