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GROUP UNIVERSAL LIFE PRODUCT

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- o Group universal life history
- o Pricing, product design, and profitability considerations
- o Market outlook

MR. WILLIAM R. BRITTON, JR: We will take a current assessment of this phenomenon called group universal life (GUL). I'll begin with overview and history, Ms. Herz will discuss reasons that employers and employees are interested in GUL, how well it is being accepted, and the market outlook. Mr. Duncan will concentrate on issues and concerns from an actuarial and insurance company perspective by describing Aetna's entry into the market, the current state of their product, and the concerns they have with it.

HISTORY AND OVERVIEW

GUL can be viewed either as the last vestige of the product revolution or as the latest and perhaps most significant development in the distribution revolution. The product revolution, in my mind, began in the 1970s with the introduction of indeterminate premium products. The introduction of universal life in the early 1980s really did create a revolution. We've seen more product change and more increasing frequency of product change in the 1980s than ever before. The pace of change has recently slowed a lot. There is very little new happening in product development. On the other hand, companies continue to struggle with their expenses, primarily the cost of distribution. As companies seek ways to get products more economically to the customer, GUL presents a good opportunity to reduce one of the major cost components, i.e., first-year commissions. Whatever your view -- whether this is part of the product revolution or the distribution revolution -- the battle has been quite interesting, and somewhat bloody so far.

GUL began somewhere around 1983 or 1984, when Johnson & Higgins (J&H) proposed GUL as an attractive alternative to voluntary term plans. Because of the uncertainty with respect to Section 79 treatment, in 1984 J&H sought and obtained a private letter ruling for IBM employees. This private letter ruling exempted the GUL arrangement from Section 79 because the employer, IBM, was to pay no part of the premiums and because the policy was to be issued to a trust. In 1985, we saw a number of blue chip cases written: IBM, ITT, Firestone, Singer, Texas Instruments, Chrysler, and several others. By 1986, most of the major group insurance carriers had developed products, including Met, Prudential, Travelers, Aetna, CIGNA, Equitable, and John Hancock. In 1987,

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we saw a kind of consolidation, with the major carriers moving down market toward smaller size cases and a number of smaller carriers entering the market.

MARKET APPLICATIONS

The primary use of GUL is employer-sponsored payroll deduction or replacement of voluntary term insurance. Here the employee pays the premium entirely. GUL has also been used as a corporate-owned or employer-owned vehicle for funding deferred compensation or other postretirement benefits. And finally, we've seen tailor-made plans for the upper-income market or executive market, particularly for law firms, Big 8 accounting firms, etc.

What are the motivations for insurance companies? Employers? Employees? Ms. Herz will cover the attractions to the employer and the employee. Ian will spend time on the attractions and detractions from the viewpoint of an insurance company. There are three primary reasons why insurance companies believed that group rather than individual was a good idea. First, filing ease and speed. By establishing a trust, a company can get approval to write in over 30 states in a very short period of time. This is very difficult to do with an individual product. Second, the product provides considerable flexibility. Cost of insurance rates can be tailor-made to the specific case. Commissions can be negotiated, and loads can be adjusted accordingly. Generally, individual products do not permit this, because of the antidiscrimination statutes. Third, carriers saw GUL as an opportunity to lower their distribution costs by selling permanent life insurance on a mass-marketing basis.

PLAN DESIGN

What do the products look like? Exhibit 1 summarizes features of the two distinct schools of plan design. One of them, which I've called a "group" type, follows the original J&H designs. The group products typically would have been developed out of the group department, frequently by people who were very familiar with group pension investment-year methods or very sophisticated group life insurance experience rating. But frequently -- and I found this quite interesting in some of the early products -- some of them were developed by people who had never before developed a universal life product. Many of the early GUL designs made the same mistakes that a lot of us did when we developed our first universal life products.

EXHIBIT 1

GROUP UNIVERSAL LIFE

Plan Design

	Group	Individual
Cost of Insurance	Step Rated	Attained Age
Interest	Investment Year Method	Portfolio
Case Termination Penalties	Yes	None
Experience Rating	Complex	Simple/None
Death Benefit	Level Amount at Risk	Level Face
Premium	"Term" Plus "Side Fund"	Target

The individual type product looks more like a payroll deduction plan, as it resembles a target premium individual universal life policy. We have two very different philosophies regarding this product. It's not clear which one is best and which will ultimately prevail in the marketplace. Exhibit 1 summarizes the differences in plan design between the individual and group products.

Let me make a comment on premiums: you frequently get what you ask for. If your marketing approach is term plus a side fund, I think generally you will get people paying term premiums with a little bit of side fund. If you market the product as an integrated product that provides protection throughout the employment period, with some accumulation that can be used for retirement, companies are finding that they are getting whole life type premiums.

THE GUL MARKET BATTLEGROUND

Exhibit 2 shows my market segmentation. There's nothing magic to the two's -- under 200, 200 to 2,000, 2,000 plus -- but the basic concept is that you've got real small cases. These historically have been the agent's turf and are characterized by very high commissions, high lapse rates, high mortality, high expenses relative to everything, and low average sizes. It's a murky market, and you've got to know what you're doing to make some money there.

EXHIBIT 2

GROUP UNIVERSAL LIFE

The Market Battleground

Where	Who	Issue
Large Case (2,000+)	Large Group Carriers	Market Share
Medium Case (200-2,000)	Everyone	Commission Levels
Small Case (0-200)	Payroll Deduction Writers	Profitability

The large case market (2,000 plus) has been the domain of the large group carriers. The middle or medium case market has been and continues to be the most interesting, because everyone is going after it. If you're selling payroll deduction primarily through agents, the medium size case offers a way to reduce the commission and get a more economical product that is more attractive to the buyer. If you've been competing in the large case market, the middle market is clearly underpenetrated and perhaps less competitive.

What have been the issues in the battleground? The large case market began with the major group carriers battling for market share. The carriers with a lot of in-force voluntary term business saw GUL as a replacement threat; others saw GUL as an entree to someone else's blue chip case with the possibility of getting the rest of the case. The early battle in the large case market has really been for market position, competing on price, primarily cost of insurance rates.

In the small case market, the companies who were there are still there. These are the payroll deduction writers, and they are still struggling to make it profitable. The companies not in the small case market are not likely to enter it. If they do, it may be to 150 or 200 lives, but not much below. They don't really want the small stuff.

So the medium case market is where everyone has been heading. As the major carriers have not been as successful as they wanted to in large case penetration, they have begun to migrate down. In a number of cases, their group representatives have taken them there. The battle in the middle case market is over commission levels. So far, the group-style commissions seem to be winning, as we see a steady move downward from traditional payroll deduction first-year commissions.

MARKET ACCEPTANCE

How successful has GUL been? I hope someone in the audience has a better handle on this than I do. I've searched the literature and talked to companies and consultants in the business. My best guess is that the number of covered lives is somewhere between one million and two million (to the nearest million), but probably nearer to one million. The Fortune 500 or 1,000 penetration has been surprisingly low. My estimate is that about 50 or so companies have actually bought, although almost all of them have been approached. The low penetration is primarily due to the length of time needed to sell these big complicated cases, as it takes a long time for the decision-making process to work with large employers. My best guess is that somewhere between 25 and 50 carriers offer GUL -- I don't think there are a 100 out there.

GUL TRENDS AND OUTLOOK

There are several perceptible market trends. As noted earlier, the market trend is downward in case size into the 200 to 2,000 life cases. But GUL is becoming available everywhere. Some of the major carriers thought at first that this would be a large case product, and didn't plan to have a small case product; but they now see that it works quite well there.

One of the more positive recent developments has been a pullback in guaranteed issue, for two primary reasons: one is concern over AIDS, and second is that a number of companies have gotten burned with spouse coverage, that is, guaranteed issue on dependents. We're seeing more caution with respect to dependents and more caution with respect to issue amounts on a guaranteed issue basis.

Next, cost of insurance rates appear less aggressive. This may be wishful thinking on my part, but I think the market is starting to steady, and that companies aren't competing so aggressively on the cost of insurance rates as they were in the early days.

And finally, compensation levels are lower, because companies are finding their group representatives like this product. It's something they can sell, it's new and different, and they are comfortable with the commission levels. Also, consulting firms are getting more and more into the act and more often than not may be looking for no-commission or very low commission products. Both of those forces are tending to drive compensation levels lower than individual-style agent commissions.

Finally, where's all this heading? My prognostication is that we'll see a lot more emphasis on savings in the marketing of GUL. There are many reasons for this. Some are socioeconomic, some because carriers are going to find that the margins in group term insurance are not sufficient to support universal life administrative systems. Even if you're only getting term premiums, you typically need all of the mechanics of a very expensive universal life administrative system. Also, it's difficult to get adequate margins just off of the term insurance. You need the buffer of some margin on the fund accumulation.

One of the more interesting developments, which could be the subject of much more discussion, is what I've called solicitation sophistication. Nobody really had a good idea of how to sell this very complicated product in a mass-marketing environment because of all the bells and whistles and flexibility of universal life. Carriers are still experimenting with solicitation. Some think they are becoming fairly successful. I heard of an 85% penetration level in a newly written case that wasn't a transfer of existing supplemental term coverage. Carriers are using group techniques, 800 numbers, and kiosks with interactive personal computers.

Another development will be in-house administration. Some of the carriers have used and continue to use J&H's administrative facility; some contracted out with third-party administrators. The very large carriers will likely decide over time that they want to bring administration in-house, where they can do it better or more economically. Moreover, they want the control over administration because of the interface with the employer.

What will happen on benefits? My favorite new wrinkle is a long-term care rider that is being added to individual universal life insurance policies. The rider will pay a portion of the death benefit, typically 2% per month, to someone who is confined to a long-term care facility. It's basically a prepayment of the ultimate death benefit. I think it's a feature that will be attractive in this market, and as it moves through the individual market it will also permeate this one.

Variable life has some problems in this market because of the SEC and the National Association of Securities Dealers. I'm not very bullish on variable in the short term because of its complexity, but I do think that variable has a good future potential. It won't take off explosively right now, but we will continue to see it develop.

MS. JULIE A. HERZ:
EMPLOYER PERSPECTIVE
Now that we've heard the background on GUL, I will talk about what makes it appealing to employers. My perspective is the employer perspective, particularly the large employer or mid-size employer. As a consultant, these tend to be the groups that I get involved with and where most of the activity is today.

Mr. Britton mentioned earlier that the GUL products tend to have two different versions: the group type and the individual type. For most employers, both large and mid-size, the group-style term plus the side fund arrangements have prevailed so far because they are replacing existing voluntary term insurance programs. As they are also much easier to communicate to employees, that style of program has been preferred.

From the employer's perspective, the key advantage is the low-cost benefit enhancement. It's a way to improve the benefit program without costing the employer more money. It's an employee payout plan. There will be some internal administrative costs associated with it, although they're minimal. It's a nice perk or option employers can offer to employees without having to spend more money.

A large employer, even a mid-size employer, has various employee classes in diverse business units at different locations. Employers are finding today that they are administering a variety of programs. They may have any number of voluntary life programs in place, which could be with different carriers; they may have some dependent life coverage offered separately or on the side; there may be some voluntary accident coverage; and right now these all require separate administration and separate enrollment procedures. GUL is a way of consolidating a lot of these voluntary coverages into one program, and thus easing the administration on employers.

Because GUL usually falls outside of Section 79, we don't have to worry about the imputed income issue or the discrimination issue. This is certainly appealing to employers, not having to worry about the calculation of imputed income at the end of the year, especially if they trim down their basic insurance allowance when they offer the GUL program. Employers don't have to worry about the fact that only their key people select the higher amounts of insurance -- it's just not an issue.

Another issue -- and this is something that is gaining in popularity -- is that employers are looking for ways to reduce their commitment to retirees, because of the proposed FASB rules on expense and liability recognition. Employers are saying that the commitments they've made in the past are no longer realistic for the future. While they may not be willing to do much about current retirees, some employers are saying they won't offer employer-paid benefits for future retirees, but they want to give the employees the opportunity to prefund for themselves for the future, and GUL is one way to relieve some of that pressure to provide postretirement benefits.

ADVANTAGE TO EMPLOYERS

As far as the motivations for GUL are concerned, increasing cost is certainly one key motivation for revamping any employee benefit program. To the employer who is looking to reduce costs but continue to offer benefits, GUL is certainly an option. It can cut back on the basic insurance but can offer employees a number of options on their own. The flexible benefits plan concept is still popular and gaining in popularity. It has escaped tax reform unscathed. We now see renewed interest in flex, and GUL is a given when flex is in place. Even though you cannot contribute for GUL on a pretax basis, it works hand in hand with the idea of flexibility in options. I mentioned that with plan consolidation and streamlining of administration, employers are finding that group welfare benefits are taking more time to administer with more laws and regulations coming out. They no longer have the time to deal with the multitude of plans and carriers, so any way they can reduce their administrative burden or consolidate plans is appealing.

For major employers with diverse business units and work forces -- trying to design programs to meet the needs of such a diverse work force but unable to come up with one program that meets everyone's needs -- GUL again fits into something that's flexible enough to be one program while offering flexibility to individuals.

Improving the tax effectiveness of benefits is an issue now and will continue to be an issue. Beginning in 1989, employers will face the new nondiscrimination rules under Section 89 of the IRS code, to the extent that the benefits they are providing now on an employer-paid basis discriminate. There will be some added tax consequences to highly paid individuals, and since people are constantly looking for a new and better way to offer some tax-effective savings vehicles to employees, GUL fits in there as well.

ADVANTAGE TO EMPLOYEES

From the employee's perspective, some of the advantages are almost the same as they are for the employer. The employer wants to offer flexibility and the employee wants flexibility. This is evident with the continued growth of flexible benefit plans, and GUL will continue to grow alongside of that. It's certainly convenient, it's payroll deduction, and it's an easy way for employees to buy inexpensive insurance coverage and still have the option to set additional money aside. Even though it is after-tax, the cash builds up, interest builds up taxfree, and it's all payroll deduction.

One feature of GUL that is appealing to employees -- even more so since the changes in 401(k) savings plans and defined contribution plans -- is that employees can get at their cash values if they need to, whether it be an emergency or because they just purely want to get at their money. Employees are finding now that the other savings vehicles that employers offer, particularly defined contribution plans, have early withdrawal penalties that make getting at their cash more difficult.

Generally, GUL is a better value for a majority of employees than individual universal life. Mr. Britton mentioned earlier that individual universal life tends to have the high commissions and expense loads, which we don't find to be the same in the group product. The cash values build up more quickly because of that, and GUL may be a better product when you are trying to appeal to the masses, especially large and mid-size employer groups. The audience is unsophisticated. They are not sophisticated buyers of insurance or investment services. They need something that is easy to understand when they don't find that more of their money has gone to expenses than it has for the purpose that was originally intended. The fact that there is no imputed income is appealing not only to the employer who has to calculate it, but also to the employee who has to pay the tax on it. The full portability is certainly a feature that is unique to GUL. There is really no other group insurance benefit right now that employees can take with them when they leave the company.

When employers come to us as consultants or go to their brokers to help them find a program, design and obtain proposals for a GUL program, we go through an evaluation process that focuses on four major categories: plan design, associated costs of the program, contractual provisions, and evaluating the carrier regarding its capabilities and experience.

Plan Design Evaluation

In the area of plan design, the most important issues to an employer are the coverage options and eligibility requirements. Is this something that only employees will be eligible for, can they purchase spouse and child coverage, does the spouse need to be covered in order for the child to be covered, or does the employee need to be covered in order to cover the dependents? Is accidental death coverage an option that can be purchased? Some of the benefit schedules are a key, particularly if you are replacing one or more term life products that are already in place or that you are trying to eliminate. What options are available? How much insurance can an individual qualify for? What are the underwriting limits? The guaranteed issue or the simplified issue limits? What are they for the employee and spouse? These will be key features that an employer will help them evaluate when they get their proposals.

Cost Evaluation
As far as the cost evaluation, there is the cost of the insurance rates and the guarantees -- in particular, how long those guarantees are in place. There are also the interest rates -- the interest crediting method, whether or not it is something that will change quarterly versus annually, whether it's based on the time of the deposit versus a portfolio or blended rate. How will it be credited? That has implications for how it's communicated to employees.

Administrative and transaction charges are also important. What will it cost to be in this program? Does everyone pay an administrative charge, whether or not they are using the "side fund"? What about withdrawals and loans; are there charges associated with those and how expensive are they? Paid-up insurance purchase rates are also of interest to employers, although initially most employees will not have much money set aside to purchase paid-up insurance. They have to be in the program for some time before they usually have an adequate amount in there. Certainly looking at the purchase rates today and what the guaranteed rates are in the contract is important.

Contractual Provisions
With respect to contractual provisions, withdrawals and loans are certainly an appealing feature of GUL. One of the things that employers will look at from the employee's perspective is how frequently can these be accomplished. Are withdrawals and loans restricted to once a year, twice a year, are they restricted to a dollar amount? As far as loans are concerned, what is the interest rate charged on the loan and does the outstanding balance continue to earn interest at the current crediting rate? What is the treatment for terminating employees?

We have already talked about portability. We also know that there are usually conversion options and the option to purchase paid-up insurance. On the portability issue, is portability such that employees who terminate from the plan can continue it at the existing rates; or do they go into a portability pool, if you will, and have a different set of rates apply to them?

On contract termination, Mr. Britton mentioned the issue of what happens when an employer decides to terminate the contract altogether and just not offer GUL any longer, or move it to another insurance company. If all the assets are transferred, will there be a market value adjustment, or is there something up front that's negotiated to say that it will not be adjusted in any way? These provisions need to be looked at before entering into the contract so that there will be no surprises later.

Carrier Evaluation
As far as the carrier is concerned, its size and its reputation are certainly important, probably more important to some of the larger employers who are in the habit of doing business with the larger insurance companies themselves. I don't think it necessarily means that only large insurance companies can hope to do business with large and mid-size employers, as long as it's a reputable company that has demonstrated that it has the ability to administer the product. Employers are usually entering into a group arrangement for the long term. They don't generally see themselves getting into a benefit program they will terminate two or three years down the road. By the same token, they don't want to do business with a carrier that doesn't look as though it will be in business for the long term either. It doesn't do any good for employee relations if it's something they are forced to rid themselves of in a short period of time.

Administrative capability is a real key. Different insurance companies take different approaches. Some do in-house administration, some contract with third parties. In cases written with J&H, there is the KVI administration. There are pros and cons to third-party administration versus insurance company in-house administration, and it really comes down to what is more appealing to the employer. By and large, employers look to the insurance company for administration. First, they don't want to have two sources to go to if there is a problem, nor do they want to hear when they go to an insurance company with an administrative problem that the problem isn't ours, it's the third party we've contracted with. The employer doesn't care, they do business with the insurance company, and that's all they want to know about. Administration is therefore key. The other issue is that GUL does have the ability to relieve the employer of almost all administration. Some insurance companies make it so simple that all the employer has to worry about is getting a report back from the insurance company each month telling them what the payroll deductions will be for their employees. That eliminates all administration altogether.

OUTLOOK

As far as the current outlook goes for GUL, we have seen a declining interest for the last year or so. There are a number of reasons for this. People are worried about potential changes in the tax laws that may tax the inside buildup, making them queasy about putting money into a program that they may feel will no longer serve their needs. Secondly, lower interest rates. Rates that were quoted a year and a half ago were really appealing, and they have decreased since then. The individual tax rate is now the lowest we will probably ever see. The idea of tax-advantaged savings doesn't appeal as much to some employees and employers.

Some employers have worried about competition with their 401(k) plans, especially with the changes in the defined contribution plans and the limits on being able to withdraw cash. If employers already have a problem meeting their Average Deferral Percentage test, they worry that some of the lower-paid employees who have less discretionary income might be more inclined to put their money in GUL instead of the 401(k) plan because they know they can get at it. From my own experience, however, the employers who have installed GUL have not experienced a problem with their 401(k) because of it.

Probably the biggest reason that interest in GUL has diminished somewhat over the past year is that employers right now have their plates full of other issues, such as the increased cost of health care and the potential recognition of liability expense for retiree benefits.

The other thing that has benefit managers concerned is the compliance with Section 89 and how to get all the data they need to conduct these tests starting next year. Because of all this, changing benefit programs right now or offering benefit enhancements are just not getting top billing. People who were studying flexible benefit programs in some cases have slowed down and taken a step back and said they will still do it, but the other issues must first be addressed.

For some of the same reasons that the interest has fallen off, the interest will again resurface because of the fact that if we have to find ways to control or manage the liability expense for postretirement benefits, one of the ways to do it is to limit the benefit commitment from the employer. When that's done, employers then look for options to give employees so that they can fund for themselves. Certainly, GUL is a way to do that. The Section 89 testing for some employers will be a hideous task, and they may just come to the conclusion that life insurance programs are too complex and causing such an administrative headache that they are streamlining some of the benefits they offer and letting the employees decide for themselves if they want to buy more. Interest in flexible benefits had also softened because it passed through tax reform without any real incident. Because it will remain a tax-effective way to offer benefits, interest is now renewing and flex will take off again, and GUL is just an automatic, or given, when it comes to flex.

As far as the long-term outlook is concerned, I agree with Mr. Britton that it won't shoot off like a rocket now or in the next year, but it certainly has the wherewithal to be a long-term product. It won't go away unless we have some tax laws that are changed to prevent this from being as appealing as it is now. GUL is here to stay and will continue to grow.

MR. IAN G. DUNCAN:

COMPANY PERSPECTIVE

As Mr. Britton said earlier, I work for Aetna Life & Casualty, and this year is the 75th Anniversary of issue by Aetna of its first group insurance contract. Much of the critical development of group insurance at Aetna rests with Edmund Ernest Cammack, who was a Fellow of the Society of Actuaries and a vice president at Aetna. For the celebration marking the anniversary, James Lynn, Aetna's Chairman, said the following about Mr. Cammack: "Cammack, a brilliant actuary, advanced the idea that you could sell insurance to employees without individual underwriting, if the employer were to sponsor the plan and pick up some of the costs." This idea was no doubt considered at the time to be actuarially unsound and somewhat radical, but I've quoted these words because it's instructive to be reminded of what has become two fundamental principles of group insurance: that every employee is covered by standardized benefits and that the employer picks up some of the cost. Ms. Herz and Mr. Britton have said enough about GUL for you to realize that GUL deviates very substantially from these two fundamental insurance principles.

Today Aetna is certainly a major group life insurance writer. However, in the last few years we have been suffering something of a decline in market share, both from other group writers and from individual universal life companies on the payroll deduction basis, who through individual universal life are able to offer a permanent product that seems to be competitive with supplemental group term insurance. Also, another major part of our book of business was group paid-up insurance, which is an annual premium whole life type of contract no longer offered as a result of Section 79 changes.

PRODUCT FEATURES

The GUL product that we sell fits almost exactly the group model that Bill described. Simply stated, it is permanent life insurance whose term insurance and investment aspects are unbundled. The product extends the trend, which began with individual universal life, to offering premium payment flexibility and market-related interest credits. For example, most products allow payment of a minimum premium equal to the cost of the term insurance benefit. So there is no requirement on the individual to fund the cash value -- he or she just has to pay sufficient to keep the term insurance going for one month. We offer high guaranteed amounts of insurance. Our product requires a reduction in insurance amount either at higher age or at retirement. The contributions are completely flexible, provided you pay the minimum required to keep your contract active. You can put in as much or as little as you like over and above that, and also change the frequency of contributions. We keep individual accounts on individuals. This is, of course, a very big change from the way in which we operated group term insurance before, where the employer was responsible for keeping the records. We are now responsible for keeping records. We keep individual account balances, and having those individual accounts, of course, allows the individuals to take out policy loans, make withdrawals, and what have you. We offer substantial continuation privileges. Should the individual terminate from the group, he or she can take the same contract pretty much unchanged, and continue to pay us on a direct-bill basis. We offer substantial amounts of dependent insurance, particularly spouse insurance. The spouse has the same benefit as the GUL benefit, and dependent children have a term rider. And finally there is a toll-free number, which symbolizes the whole way in which we administer this product, which is individual oriented. We communicate with the individual employees and they communicate with us, often through the toll-free number; unlike group term insurance, where we communicate with the employer, and if the employee has a question he goes to the employer (Graphs 1, 2, and 3).

This is the product that we have developed and are selling today. This has had some very interesting consequences for us, as we are essentially a major group health insurer. Although it was conceived basically as an extension to an existing plan, namely the group term plan; the way it's conceived, designed, marketed and positioned has had very significant implications. For example, we have entered the individual insurance business. A major marketing point of the plan is that the employer is not involved in communicating or in ongoing administration of the plan. We offer the employee, through an 800 number, the means of communicating directly with us. The employer does not want to be involved.

Second, we have reentered the risk business. In recent years, we largely left this either through writing administrative service contracts or through financial arrangements with employers that enabled us to pass all the risk back to the employer. With this product we offer guaranteed rates upfront, often for a period of years. We offer high amounts of insurance, and we offer to cover spouses. We consider this to be a very risky product.

Third, unlike other products, GUL is not an employer plan. Although the employer may be sponsoring it, the employer cannot contribute financially towards it. And there's a somewhat questionable sense of ownership on the part of the employer. How prepared is the employer to stand behind this plan if something should start to go wrong with it financially?

Fourth, by being largely in the term replacement market, we severely limit the term insurance rates which we are able to charge. We have to remain competitive with supplemental group term insurance.

We decided to maintain individual records on all enrollees, including those who bought term insurance only. This is partly because we are hoping down the road to sell them the idea of starting a fund, but also because the employer does not want to maintain the records on these people. By selling the coverage on a group basis, we took over a role traditionally filled by an individual agent or by an individual enroller. We have given this job to our own group field force, where it does not sit particularly easily at the moment. These people are experienced in selling health insurance plans to brokers, to consultants and to employers. They are not experienced at selling individual insurance to employees. As I said, we take the term plus side fund, the group approach, to this

GRAPH 1

COMPARISON OF PRODUCT FEATURES

FEATURE	SUPPLEMENTARY TERM	INDIVIDUAL UNIVERSAL LIFE	GUL
Employer contributions	Yes	No	No
Minimum premium	Term premium	Whole life premium	Term premium
Expense loads	Group	Individual	Group
Cash value	No	Yes	If optional contributions are paid
Guaranteed issue	High	Low	High
Enrollment	Written/ group meeting	Individual meetings	Written/ group meeting

GRAPH 2

COMPARISON OF PRODUCT FEATURES

FEATURE	SUPPLEMENTARY TERM	INDIVIDUAL UNIVERSAL LIFE	GUL
Individual record-keeping	No	Yes	Yes
Cancellable by insurer	Yes	No	Yes
Convertible to whole life	Yes	No (product is whole life)	Yes
Continuation by individual	No; conversion only	Yes	Yes

GRAPH 3

COMPARISON OF PRODUCT FEATURES

FEATURE	SUPPLEMENTARY TERM	INDIVIDUAL UNIVERSAL LIFE	GUL
Reduction at retirement	Substantial	None	Substantial
Frequency of rate revisions	Annual	Infrequent	Annual
Guaranteed rates	No	Yes	No
Dependent coverage	Yes	Yes	Yes
Surrender charges	N/A	Individual	Minimal

product, and there are some legal risks to this as well. There is a possibility that the IRS may consider this approach not to constitute a plan of permanent life insurance under Section 7702.

This is the product that we are selling, and some of the implications that it's had for us. I want to go on to talk about some current actuarial, underwriting and financial problems which we are seeing.

ACTUARIAL CONCERNS

GUL is fundamentally a riskier product for us, we believe, than employer-paid coverages because we cannot rely on employer funds to make up an emerging deficit. At the same time, because we are in the term replacement market, we are constrained in what we can charge customers. Of course, you've heard about the competition. This has been described by one actuary as GUL being priced in a manner that is expecting the dead to jump out of their graves with the enthusiasm of Lazarus. The following are some of the factors affecting financial status of the product.

First, it is entirely optional, so participation on the part of the employee is optional, and the employee can select from a wide range of schedules, often up to five times salary. Amounts increase with salary, often without evidence of insurability. Rating is often done from unrelated or not too relevant experience, and the quality of data from which we have to rate is often poor. Consultants market this product as a death-benefit-only product, even though because of the continuation provision we are going to retain lives who are disabled as well as retired employees. Individuals may elect to continue coverage on a direct-bill basis following termination of employment. We always impose a reduction in the insurance amount either on retirement or on age, although the market is not clear about this. Often employers and consultants demand unreduced amounts. There are extended rate guarantees. There are often lifetime guarantees on the maximum mortality rates which we are able to charge, which is certainly a foreign concept to group insurance. It's a fixed-price contract. There is very high demand for the services that we offer -- for example, the 800 number. There is the dependent insurance, the fact that we invest in long-term assets offers the employee the opportunity to disintermediate should he wish, and finally on plan termination, the market generally appears to demand that the individual be given the opportunity to elect to continue if he so wishes.

EXPERIENCE RATING

I want to discuss about five of these problems in more detail. The first of them is rating. Since GUL is a new coverage, relevant and comparable data are generally not available. We try to rate using what is available, and the sort of problems that arise include the following. We rate from dissimilar or often irrelevant information. Employers demand that their experience be given credibility, however, and that they be given a discount off whatever standard rates we are proposing. Often we are not really very clear as to what the provisions of the plan from which we are given the experience are, particularly with respect to continuation on disability and retirement. We have to guess at the expected participation level, and because we have to set the price upfront, we cannot adjust that price or the rates that we charge to the employees should that participation level not be met. We cover spouses at the same rates as we offer the employees. One aspect of concern is the widely divergent rating which is emerging on often very similar groups. Some of this may be due to the poor quality of the data available from which we rate and the different interpretations that can be given to the same data. Nevertheless, over time there may be a tendency for rates on different maturing plans to trend together, which is going to mean that those employers who are able for some reason or other to negotiate a very steep discount are going to be faced with substantial rate increases.

This may particularly happen as the balance between active employees and former employees, who are either portable or continuing in some other form, changes in favor of those who are continuing. Given the uncertainty which surrounds GUL in terms of participation, antiselection, and options to select from the schedules, higher than normal risk margins seem to be necessary. It would appear to be in the carrier's interest to offer a participating arrangement. Such an arrangement would appear to be attractive to the employer, who is concerned about the long-term stability of his rates. Yet so far, to my knowledge, no GUL plan has been sold on this basis. It seems as though the employer is always concerned simply to get the lowest rates that he can from the carrier. One possible reason for this is that the employer perceives some kind of fiduciary responsibility on behalf of the employees, and because only employee funds are involved. If this is true, I think there is some implication of a long-term inability to rate this business adequately and to make a profit. It's very possible that once the rate guarantee expires with one carrier the employer will shop the market and shift to the carrier bidding the lowest, and we will find this business shifting around from carrier to carrier -- in which case, none of us will make a profit in the long run.

UNDERWRITING AND EVIDENCE

The second point of actuarial interest is underwriting and evidence. It would be true to say that the feature which most clearly distinguishes GUL from individual universal life is that we offer higher amounts of guaranteed insurance with no evidence. We have always done this under supplemental group term life insurance, so this is not a new concept. What is new about GUL is the following: (1) coverage increases in line with salary increases, often without evidence; (2) the market demands unreduced amounts of insurance at high ages; and (3) the high amounts of insurance offered on spouses. I accept that the individual has no opportunity to select against us by awarding himself a salary increase; however, I see no reason why an uninsurable individual should be able, year after year, to continue to increase his amount of insurance in line with these salary increases, and for this reason we always require evidence on coverage increases due to salary. With regard to high ages, the individual has a clear selection opportunity. Because the plan may not terminate before age 95, being a permanent life insurance plan, we are obliged to offer coverage to older participants. Obviously those in good health will not pay the increasing cost of term insurance as they age, leaving us with only those who have a health problem, who will keep as much insurance as they can for as long as they can. The problem with spouses arises because so far there is no really satisfactory way, short of a health questionnaire, of judging their fitness for insurance, and most employers, when they want coverage extended to spouses, demand this on a guaranteed issue basis. With employees we can obviously impose an actively-at-work condition, but we have no corresponding criterion to apply to spouses. We think other carriers in this market have definitely experienced a selection problem from spouses.

CONTINUATION

With respect to continuation, under supplemental term insurance, the terminating employee was given the opportunity to buy a whole life conversion policy, and we assessed the charge to the employer to cover the extra risk. Under GUL, we offer a conversion policy. But obviously the continuation of the GUL certificate on a direct-bill basis is a much more attractive feature, and most employees who terminate and who want to continue insurance buy it. We have no problem with doing this as long as the employer plan stays in force, because there is always a good chance of renewing the plan at adequate rates if for some reason we experience a problem with this group. What we do not like is that there is a demand in the marketplace for a product which allows individual election of continuation, even on a term-only basis, on cancellation of the plan by the employer, or worse still, on transfer of the plan from one carrier to another. One argument advanced for the soundness of this design is that those individuals will be placed in a pool and charged pool rates. We feel that this is unsound for the following reasons. There are just too many other plans available at competitive rates to terminated individuals, whether from a new employer (which may even be subsidized) or from an individual agent. Our experience with group conversion policies shows us that the lives electing continuation from group insurance on termination of employment are often uninsurable, and the rates appropriate to such individuals are many times standard mortality. We are able to offer group conversions only because of the employer's continuing support of the group plan. We expect the experience of those continuing on termination of the entire plan to be even worse than those who convert on termination of employment, because in addition to those who would normally convert on termination of employment buying the continuation, we will have those who would have died and been recorded under the employers' experience had the plan continued in effect. In addition to this, we have the very high amounts of insurance that we are extending as a further complicating factor. For these reasons we believe that we cannot offer continuation as an individual election on termination of the employers' plan.

INVESTMENT

We are very concerned about disintermediation. The market demands a plan without surrender charges, without investment selection charges, without market value adjustments, both on individual withdrawal or on surrender or termination of the plan by the employer. Our reaction, however, is similar to our reaction to continuation. Provided the employer plan stays in effect, we believe that we can handle and work through with the employers the problems of individuals withdrawing their cash balances. What we are not prepared to allow is the employer to select against us by choosing timing of the cancellation and transfer of those funds. For that reason we impose a market value adjustment on plan termination.

ADMINISTRATION

The final point is administration, which is something we have to do and something we have to do right. The particular problems that GUL presents from an administrative perspective relate to our relationship with the employer and the employer's expectations of us. Most employers who have group plans are used to asking their carriers to do things for them and then paying for it at the end of the year through their retention. With GUL, however, we cannot charge the employer for these additional services which we render. We have a fixed-price contract with the price agreed up front. Employers always believe that they know what is best for their employees, and try to intervene and demand additional services. Because we are hoping to sell and retain other group insurance business with the employer, we obviously have to try to satisfy their demands, which we are finding substantial, particularly with services like the toll-free number. We obviously have work to do here with employers, making them understand that this is a fixed-price contract, and that whatever services were negotiated up front are what we are able to offer for that price.

OUTLOOK
I want to say a few words about the future. I believe that the present which I have outlined for GUL is not altogether a happy one. I cannot say that the future of GUL is assured. Indeed, I perceive, like Ms. Herz and Mr. Britton, a cooling off of interest at the moment, although there remains a fairly steady demand. Factors that turn employers off the product and warning signs that exist now are the need for significant rate increases in the future, the inability of carriers to deliver quality service at the agreed price, and some changes in the tax laws. Of these three, there is not much that we can do about the tax laws, and new legislation could actually be beneficial as easily as it could be harmful to us. The second point is up to the individual carrier to deliver quality service at the agreed price. What we have most control over is the first point. If the product is soundly designed and priced, the need for rate action will be minimized. This requires that we take a close look at product features, particularly those which offer individuals significant opportunities to select against us. While we can neither offer standardized benefits under this product, nor require employer contributions, we can try to remember those two principles which I enunciated at the beginning if we want to make this a successful product and stay in the GUL business.

MS. KATHERINE C. COON: Mr. Duncan, you painted a bleak picture of the situation. What keeps Aetna in the business of GUL?

MR. DUNCAN: I'll say what Mr. Britton said -- "inertia." In a big company, it is like steering a ship; it's difficult to change course. We do see this as being an opportunity for us, and one thing I omitted to say earlier was that we have reversed the decline in our GUL sales, so it has been successful for us from a marketing point of view. We think with the relationships we have with the employers to whom we've sold the plan that over the long term we can work through these problems and make money.

MR. ROGER S. PALMER: Mr. Duncan, I understood you to say that you structured your plan so that it didn't conform with the individual nonforfeiture law. Is that correct?

MR. DUNCAN: Because we have the market value adjustments, we wouldn't conform to the individual nonforfeiture law; that is correct.

MR. PALMER: That's my next question. We structured our plans to follow the individual nonforfeiture law, and we weren't aware of the market value adjustment that other carriers were using. Upon rethinking that, it will have to be changed.

MR. BRITTON: I'd be interested in Ms. Herz's comments on market value adjustments from the standpoint of acceptability to employers. How important is this in the purchase decision?

MS. HERZ: From the employer's perspective, I think it's important on individual terminations especially. That's what critical. They don't want a situation where employees who leave the company and elect to take their cash value rather than maintain the portable policy or purchase paid-up insurance and suffer a loss as a result of a market value adjustment. On the contract termination side, I don't think a lot of employers gave that a lot of thought initially, and we perhaps provoked some of that thought during the review process of the proposals. It needs to be thought out that if an employer does decide to terminate a contract at a later date and if the employer intends to transfer all the assets to a new carrier or simply eliminate the contract altogether, every employee has the option to just cash out. I don't think employers are so unintelligent as to think there is a free lunch. They are seeing how attractive the product is, the rates have been very aggressive, the interest rates have been favorable; but on the other hand they look at it and say, "We never want anyone to lose any money in this situation." They don't want to look like the bad guys, even though there is not an employer plan in the same sense as other group insurance plans are. There is no way to ever separate the employer from this plan once it's sponsored by them. The employers are looking for ways to minimize the market value adjustment on contract termination and maybe agree to negotiate some arrangements, but on the individual terminations they are just not willing to go with market value adjustment.

MR. PETER T. LECLAIR: Mr. Duncan, with respect to guaranteed issue and the requirement of some evidence in the case of a salary increase leading to increased benefits, is there any consistency in allowing guaranteed issue up to a certain amount at initial solicitation but thereafter requiring evidence for increases? Also, what is the maximum amount of guaranteed issue that you are currently using?

MR. DUNCAN: The maximum amount of guaranteed issue we will write depends on the size of the case and how much premium we are expecting to take. For example, a big case, we could very well have $100 million guaranteed issue, but at entry to the plan the employee satisfies an underwriting requirement by being actively at work. The way in which we would do salary increases would be for only those increases which would put the employee above the level of $100 million to require evidence. Most employees are going to go for a substantial period of time without having to provide evidence of insurability for increases.

MR. SCOTT C. THORNTON: With respect to the cases where GUL is replacing a supplemental group life plan, what if an employer decides to retain the supplemental group term life, but offers universal life on top of it, so that there are two programs. What has been the experience?

MR. DUNCAN: My comment on that is that we would not do it. If the employer wants to offer something that competes with the supplemental term plan, there's too much selection going on. We would direct those employers to other products within the group division which offer the investment or the salary savings opportunity and keep the supplemental in place. That would be one way around it.

MR. BRITTON: I think it's unsound to offer both, particularly if there are large amounts of coverage involved, because it does offer individuals the opportunity to accumulate coverage. One of the difficulties in the replacement of these voluntary term plans is that the rates typically are flat, and the older age people are being subsidized. For them the advantages of GUL are not that great, because their rates will go up a lot. For the younger generation, the rates will likely go down because they will now pay the appropriate rate for their age. So if you allow options, you can figure out the kind of selection you are likely to get: the older ones will stay and the younger ones will move. If it's the same carrier and plans are split and you continue to keep the old ones, you are now going to have to raise rates; then I don't think you can offer an option.

MR. THORNTON: What sort of other products would you recommend?

MS. HERZ: I got involved in a situation with an employer who wanted to offer their executive group more benefits and were not interested in eliminating their current supplemental term life plan. An individual universal life salary deduction program was appealing and was offered in concert with the other program. I agree that running the two side by side would be problematic. It also doesn't make a lot of practical sense; it's adding another plan that employers have to make sure is communicated, and it's confusing.

MR. BRITTON: You could still use a group product in that situation, but you would want to have more of the normal underwriting, either short form or something like that.

MR. ROBERT G. UTTER: What are the initial enrollment percentages you are seeing? How do you handle the ongoing solicitation if the employer's not involved?

MR. BRITTON: I've seen a wide range of initial enrollment percentages. I threw out a number of 85%, which was quoted to me by one of the major carriers. For that particular carrier, something like 50% would be what they are averaging, but then I've heard numbers substantially below that in other situations, more in the 20% to 30% range. I think the participation you get is a function of the way you are approaching the employees.

MS. HERZ: I think another key on the ongoing participation is good communication materials that are easy to understand. Even though employers cannot participate in the cost of the program, and usually keep an arm's length in administering it, they do want to be sure that a program is successful. The better you can structure your communication enrollment material, the greater the success of getting people to enroll.

MR. BRITTON: The importance of employer sponsorship can't be underestimated. One of our consultants tells of an experience with a former company which had sold a payroll deduction plan to a textile company with a German owner. He went out with the enrolling team on the first day, which drew all the bad risks. Some of the German management team happened to be visiting and wanted to know why the consultants were wasting the people's time. You must have the employer behind you all the way.

MR. DUNCAN: From our experience, we have something like 55% or 60% participation. It fluctuates, but that's average. In the term insurance piece of it, something like 15% to 20% of those people contribute to a cash value.

On how to handle enrollment in an ongoing fashion, it's basically the same. Once a year, the employer permits us to resolicit, usually by mail depending on what the participation is like. If you're getting 60%, there is not much more you can do.

MR. MARK A. DAVIS: Do you find employees are making significant contributions to the side fund, and if not, doesn't that present a profitability problem to the insurance carriers?

MR. DUNCAN: We are not all that concerned about the level of participation in the side funds. We are expecting to get that up over time. I think the average side fund contribution is about $300 per employee per year, which is not an insubstantial amount. Our biggest concern is over the term insurance pricing and the underwriting of the term insurance.

MR. BRITTON: That is somewhat consistent with my experience in the payroll deduction market. Something like $2 to $3 a week is where that market used to be when companies started coming out with universal life products, although they needed $4 to $5 a week to make the economics work. I've had discussions with a carrier who is approaching the market with two different kinds of products: one is a term product with an optional side fund, the other a GUL. They find when employees buy the GUL, about 40% have been opting and putting money into the side fund on a target premium basis. They are also finding that it's essentially a money purchase sale. Employees have just so many dollars to spend each year. If you let them spend it on term insurance, they may spend it on that; if you establish a side fund, they'll put it there, but you may not increase the overall premium that much. With the product that they are marketing more as a term than as a universal life, they are finding a lower percentage, about 15%, participates in the side fund.

MR. DUNCAN: We have a few who contribute a substantial amount on a regular basis.