RECORD OF SOCIETY OF ACTUARIES
1990 VOL. 16 NO. 3

# ANNUITY PRODUCT DEVELOPMENT UPDATE

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MR. DOUGLAS C. DOLL: John Fenton is going to talk about variable products. Mike Winterfield is going to cover fixed products from a product design point of view. Paul LeFevre is going to cover annuities from a distribution and marketing point of view.

MR. JOHN MICHAEL FENTON: We are going to talk about variable annuities, including recent sales results for the products and trends we're seeing on variable annuities, the investment options and programs typically found on the products, some of the distribution issues involved (Paul LeFevre will talk more about this), and finally, a few actuarial issues on variable annuities.

First, how are variable annuities doing? Right now, sales are booming. Sales were up 30% in 1989 over 1988 levels and we expect to see continued growth in the 1990s. The outlook is rosy. Of course, it's not hard to sell a variable annuity when the Dow Jones is at 3000. The key question, though, is what's going to happen when we have another downturn in the stock market? I believe that will be the real test of the product.

One of the big reasons for the success of the product is that it has replaced the single premium variable life insurance product as the variable, tax-deferred investment of choice. A significant part of the increase of variable annuity sales happened when the 1988 tax law made single premium life a less attractive alternative for investment vehicles.

There is a significant amount of new product activity in variable annuities. The product design is relatively stable, so most of the activity is on the distribution and investment side. One of the best ways to differentiate your product from others is the funds that you offer.

The focus of my presentation will be on single premium deferred variable annuities. Most of the figures I quote will be from VALUE, which is the Tillinghast Variable Annuity and Life User Exchange, covering 35 companies selling deferred annuities.

Let's look at some industry-wide variable annuity sales results. Production increased significantly from 1984 through 1989 -- $1.0 billion in 1984, up to $7.5 billion in 1989.

There were moderate increases in production from 1984 through 1987 as the bull stock market continued on, bringing sales up. It's interesting to note that sales increased significantly in 1988, even though the stock market had crashed in October 1987. The primary reason for that is the tax law. In 1989 there was a 31% increase in sales over 1988. It's worth noting that the single premium deferred annuity (SPDA) product had a sales increase of only 3% in 1989. Some recent figures from companies selling variable annuities show that production is up 35% in the first quarter of 1990 over comparable levels in 1989.

I should point out that the sales figures here include companies selling at least some nonqualified business. It would include the qualified business of companies who sell nonqualified business. The figures exclude companies selling only qualified business, such as those active in the teachers market. About 50% of the 1989 figure is qualified business. Finally, the sales figures include fixed account business as well.

Now let's take a look at some sales results for a few of the big players in the variable annuity marketplace. IDS leads the chart at $830 million, followed by Prudential, Equitable, Integrated Resources, and Lincoln National. Together, those five constituted 40% of the market in 1989. There's really no one predominant leader. There are many companies selling a significant amount of variable annuities.

Let's turn to the product side. What does a typical variable annuity product look like? The contract is purely back-end loaded. The initial surrender charge might be 5-7% of premium and the surrender charge period lasts for six to eight years. Surrender charges are usually waived on annuitization of the product. The product contains asset charges, one of which is the mortality and expense (M&E) risk charge. This is designed to compensate insurers for providing M&E guarantees. For the past few years, the SEC has effectively capped this charge at 125 basis points, somewhat less than what you can get on an SPDA contract. There also is an investment advisory fee, which generally passes directly to the investment manager of the contract. There are no specific limits on these charges, rather they must be reasonable. Investment management charges typically range from 40-75 basis points, varying, of course, by the type of fund; lower for money market, higher for equity funds.

The contracts contain administrative charges as well. A standard design is $30 per policy per year. We also frequently see a penalty-free partial withdrawal provision, which says that 10% of the premium or the fund can be taken out annually, without the imposition of a surrender charge. And, finally, we have the guaranteed minimum death benefit (GMDB). This provides that, on death prior to annuitization, the product pays the greater of premiums paid or the account value.

What are some of the new product features that we're seeing on variable annuities? Some products introduced in the past few years have had lower M&E risk charges, less than the maximum of 125 basis points. This is usually tied to products that have lower commissions, a shift to other types of asset charges, or a front-end load. One new type of charge is an asset-based distribution charge. One particular contract assesses a charge of 15 basis points in the first seven policy years. When added to the surrender charge, it has to be capped at 9% of the premium. When this is added to the M&E risk charge, you approach the interest spread found on the SPDA product. Another new product feature is the persistency bonus. One product credits a 1% of premium bonus up front. It disappears if the policyholder lapses in the first seven policy years. There are also a few no-load products in the market. By no-load I mean no front- or back-end loads. They still have asset charges. They've had rather limited success to date, primarily because of the means of distribution.

A few contracts now offer an expanded partial withdrawal provision. Instead of just allowing 10% of premium, they might also add in interest earnings as well, or increase the 10% figure to 15%. If you have a relatively stable product design, this might be one way to differentiate your product, if you can afford to incorporate it. We're also seeing enhanced GMDBs. The death benefit might be based on premiums growing with interest, say, 5% per year. Alternatively, you might periodically reset your minimum death benefit to the account value on a recent anniversary. We've found that credited rates on fixed accounts are also becoming more competitive. They are coming closer to SPDA rates.

Finally, one new product offers a market value adjustment (MVA) on a fixed account. The basic thrust of the variable annuity, as we all know, is to pass on the investment risk to the policyholder. This was fine until the stock market crashed and the policyholder wanted guarantees. Companies rushed to introduce a fixed account, which was great, except for the disintermediation risk it posed. So the solution is a fixed account with a MVA. There's one product that I referred to that incorporates this feature, but I believe others will offer it in the near future. The product offers a choice of various interest guarantee periods from 1-10 years. And there is a MVA on any transfers or withdrawals from the fixed account. It uses a typical MVA formula, which is a function of existing and new credited rates and the period remaining to maturity. Sales activity for this particular product has been quite high, generating significant increases in sales with a fair amount of money being directed to the fixed account.

Next, I thought it might be interesting to compare some design features of the product of the top five sellers of variable products, with the five lowest load products. "Lowest load" can be difficult to define on a variable annuity, but we've chosen to define it as including asset charges and front-end loads. We've ignored surrender charge, arguing that they will wear away over time. We also included the investment advisory fee in the asset charges. The five lowest load products aren't necessarily the best seller. They account for only about 20% of the total production of the five top sellers, even though their average asset charges are about 24 basis points less. The lowest load products pay a first-year commission that is about 2.5% less. What this comparison probably means is that stockbrokers have had a lot more success selling this product than the direct marketers.

Now let's talk about a few of the annuitization issues on variable annuities. Most of the money in variable annuities is still in the accumulation phase. To date, only a small percentage has annuitized. The big sales of deferred annuities were in the past 10 years, so most of the money is still prior to the retirement age. When policyholders are given a choice of annuitizing, they tend generally to annuitize into the fixed option; 75% of variable annuities annuitized in the fixed option, rather than the variable. It's also worth noting that some variable annuity products don't even offer a variable payout. They only offer fixed payout. However, there has been some recent product activity in the immediate variable annuity area, and I expect to see a significant amount of product development over the next five years or so. There will be a large amount of deferred annuity money getting ready to annuitize, and I think variable annuities will have a significant part.

Now I'd like to turn to the investment area. There are many different investment options on variable annuities. Generally, they parallel the funds that are available on mutual funds. We've noted that there is usually a lag of about one year in introducing the variable annuity fund. Everyone has a stock and bond and money market fund. In the past few years we've seen the addition of a junk bond fund, real estate, global, international, and government securities. The hot new fund right now is the balanced or asset allocation fund. Fidelity just introduced its Asset Manager fund. Another relatively new fund is the index fund, designed to mirror the Standard & Poor's (S&P) 500. The theory is that the investment managers generally do not outperform the S&P 500, so if you can't beat them, join them. One big advantage to the index fund is that it's the lowest expense fund. Other types of funds that we have been introduced to are gold, natural resources, and environmental funds. Right now, most of the money is going into the equity funds.

Now I'd like to talk about investment programs found on variable annuities. Most of these programs have been used on mutual funds and are now being expanded to variable annuities. The basic thrust of these programs is to alleviate a policyholder's concerns over investment volatility. The first is dollar cost averaging. The way the program works on a single premium product is that you put the money initially in the money market fund, and then there are periodic transfers into the other funds that have been chosen. This reduces the risk of investment volatility.

The next program is the asset allocation. There are two ways to do this. One way is to have a one-asset allocation fund, or you can use an asset allocation program with several different funds. When there are several different funds, you don't have to add a new fund. However, the disadvantage to that is that you're going to have heavy transaction costs moving from one fund to another. Also, there is a legal concern over whether policyholder money can be moved automatically without the approval of the policyholder.

The next program that we see is the systematic withdrawal. This is used on qualified money, where payments are calculated to meet IRS minimum withdrawal requirements. Another new program that we see is where monies are sold at automatic trigger points. That is, the policyholder gives permission to automatically move monies to the money market account from the other accounts, at preset high or low prices. This allows them to lock in gains or to minimize losses on their funds.

Finally, we have a program that generates an automatic allocation between the variable and fixed accounts. This is similar to programs we saw on SPDA contracts with split annuities. You invest a portion in the fixed account. The amount grows to your original investment and the remainder is put in a variable account where you can take a chance, so to speak, on the other types of funds. An example might be as follows: Of a $50,000 initial investment, you put $29,200 into the fixed account for a seven-year interest guarantee period. At an 8% interest rate, this would grow to the original $50,000 and the remaining $20,800 would be put in the variable accounts. The purpose of this particular type of program is the guarantee of principle concept that appeals to people in today's market.

Today, a significant portion of monies are going to the fixed account. A survey that we have done shows that about 35% of monies are being contributed to the fixed account, both in 1989 as well as the first quarter of 1990. This percentage varies significantly by company, from 5-85%, but the average is 35%. We have also noticed that credited rates on fixed accounts are becoming much more competitive. As of December 1989, the latest date for which we had figures available, the fixed account was crediting an average of 8.04%, while the SPDA products were crediting an average of 8.07%. It shows that fixed account rates are becoming much more competitive. In designing a fixed account, it's very important to have restrictions on the transfers and withdrawals out of your account. The typical provision would limit withdrawals to 25% of the account value during a 30-day period following the anniversary. With anything that is more liberal than that you really have to be concerned about the types of assets in which you are investing -- you should be purchasing shorter-term assets. Another trend that we're seeing on fixed accounts is the introduction of expanded interest guarantee periods, up to 10 years. Some products have guarantees of three years, but withdrawals and transfers are limited during those periods.

Insurance companies selling variable annuities use both internal and external fund managers. The external fund managers have a large role in this marketplace. Often the manager's name is used to attract monies. When we have a relatively stable design on the variable annuity, the fund choices are often the key differential between various products. Some of the big players that are in the fund management area include Fidelity, Oppenheimer Management, Scudder, Templeton, T. Rowe Price, Value Line, and Wellington. There are several other managers also in the arena, and others are coming in all the time. We should note that there are some internal fund managers, such as Pruco and Equitable, who have a significant amount of money under management.

One other trend we're starting to see in the fund management area is a concern over having profitable funds. Some fund managers tell me that you need up to $250 million to break even, somewhat less for money market funds. Many funds do not have that kind of money and will not expect to have it any time in the future. So we are starting to see some instances of a fund switch on variable annuity products. There are two ways to do this. You can either close your fund or merge it with another fund, but this usually requires the policyholder approval. Another option is fund substitution, and if this is permitted by the prospectus, it's a much easier approach. I thought it might be interesting to note the process that one has to go through to do a fund substitution. One company has recently undergone this in the variable annuity market area. First, the insurance company would get approval from the company directors. Then they would develop and file an exemptive order application with the SEC. After approval, they would give the shareholders 60 days to move their money into other funds that are available, and at the end of the 60-day period, they would effect a transfer. This whole process takes about three to four months. There are some complications involved, but generally it is a fairly straightforward approach.

It might be interesting to compare investment returns on variable annuities with those found on mutual funds. What we are using here are benchmark indices for mutual funds, for various types of funds; money market, stock, asset allocation, and international. The average return on the mutual funds is consistently higher than the variable products, about 100 basis points on average. This is, I believe, because the variable products charge higher asset charges, such as the M&E risk charge. The equity fund differences are significantly larger, probably because of the differences in investment managers.

Now I would like to turn to distribution. There are several different distribution channels on variable annuities. This has been an area of great activity recently. Carriers and distributors are working on various arrangements to distribute variable annuities. Paul LeFevre will discuss this in greater depth. To date, probably the biggest sellers of nonqualified annuities have been the stockbrokers. Mike Winterfield told me about a study of the top 20 New York stock exchange member firms. Last year they sold $9.5 billion of deferred annuities. Of that, about 18% or $1.7 billion was variable annuities. This percentage varied significantly from one house to another, from 2-50%, probably depending on the firm's orientation to variable products.

Agency field forces, of course, are distributing these products as well; they've generally been more successful in the qualified market than the nonqualified. We are starting to see greater involvement from financial planners. For banks and thrifts, to date, most activity has been on SPDA products, but we are starting to see more and more attention given to variable annuities. The question is whether individuals who are used to buying guarantees at the banks will be interested in a variable annuity product without guarantees. This remains to be seen. And finally, direct marketing. There have been a few no-load mutual funds active in this area, but their success has been somewhat limited to date. However, I do expect to see much greater expansion of their involvement in the near future.

New York Stock Exchange member firms indicate that there are several keys to success if you want to distribute a variable annuity through the stockbroker channel. First, they're looking for a long-term relationship with a carrier. They don't want carriers to be in and out of the market. They're also, of course, looking for adequate capital and surplus levels. If you sell a back end loaded variable annuity, it generates a cash strain. Member firms want a commitment to sell hundreds of millions of dollars of variable annuities, and they want to make sure you can handle that amount for this year, next year, the year after. Also, pay attention to the ratings of Best and other organizations -- those are important. Quality service is also mentioned as a very important differentiating characteristic. You have to have wholesaler support and you need to have an 800 number. Another way to attract the stockbrokers is to tie in with their mutual funds. And finally, you have to understand the broker's motivation. The product has to be simple. Annuities are an accumulation product, first and foremost, with contractual guarantees and tax deferral, so keep it simple.

Finally, I'd like to close with a few actuarial issues on variable annuities reserves. There are two types of reserves for variable annuities: basic and the GMDBs. The model regulation for variable annuities is not at all specific about reserves. It says that reserves for variable annuities should recognize the variable nature of benefits. That's it. We have done surveys that indicate that companies are holding reserves anywhere from the cash surrender value to the account value, sometimes doing a Commissioners Annuity Reserve Valuation Method (CARVM) calculation, where you might accumulate at a rate equal to the valuation rate net of asset charges and discount at the valuation rate. This results in a reserve less than the account value. Also, the level of reserves you hold depends on the tax reserves that you like to hold.

There is also a GMDB reserve on variable annuities. Companies use several different approaches to calculate this reserve. Generally, it is either a percentage of premium or a percentage of assets. Other companies do a seriatim calculation, assuming the assets depreciate by one third and measure the one-year term cost of that. So there are many different ways to go. Right now there is really no standard industry position on either approach. I would also like to point out that on a back end loaded variable annuity, there's a difference between the cash and the statutory strain. Even if you hold statutory reserves equal to cash surrender value, you have to invest the full premium into separate account. This gives you a cash strain that is greater than your statutory strain and you do have to pay attention to that in pricing the product. This can be offset somewhat by selling fixed account products.

Finally, target surplus. We're in the process of doing a survey right now and we have some results in for seven companies selling variable annuities. Of the seven, three indicated that they're holding .5% of reserves on separate account reserves, somewhat higher on the general account. Another indicates that they hold 2.0% of separate account and general account assets combined. The third indicates that they're holding 5.5%. This company is not really differentiating between their separate account and general account business. Finally, two companies don't make any provisions at all for target surplus. So you see there is a wide range and it really depends, of course, on how important your variable business is in relation to your total business.

MR. MICHAEL WINTERFIELD: John Fenton has spoken about the variable side of the business. I'll be talking about the fixed side in regards to the 1990 marketplace. There are three basic themes that I'd like to cover: more product diversity, more disintermediation protection and, at the same time, some different financial challenges. A fourth or underlying theme I'm going to be talking about is reaction -- reaction against the traditional kinds of product designs and reaction against many of the pricing procedures associated with these products.

Let me back up a bit. I'm one of the people who has been responsible for putting a lot of assets on companies' books through the traditional product design. Various products that I designed for my former company, Equitable, and for some other companies, probably now total more than $10 billion in assets. However, I've come around to the point of view in the last couple of years that there's a better way to do it. I'll give you some idea as to how I arrived at this change as I go through this talk.

To start off, let's just note the size of the market. John had spoken about a $7 billion variable annuity market. We're estimating this year that the deferred annuity market will be in the neighborhood of $25 to possibly $30 billion. At the same time though, I would certainly agree with John that the variable annuity market is going places and I would expect that it would pick up market share in the future.

To set the stage for the new products, let's take a very quick look at some of things we went over recently. If we look at the traditional product design, there are a few very basic features. We have a disappearing surrender charge that goes for 5-10 years. I would say within the last couple of years, the trend has been toward the shorter end of the range, although the surrender charge is a little bit steeper within that shorter end of the range. Say five years ago, the norm was a 7, 6, 5, 4, 3, 2, 1; currently, I think it's more like a five-year charge at a 5% level, to a six-year charge which starts at 6% and drops down very gradually. This product has initial interest guarantees of 1-7 years, although the one year predominates. Renewal guarantees are limited to just one year to be in line with disappearing surrender charge; and of course, the product can be offered either with or without a bailout rate.

What are the problems with this product? If we look at it from a marketing or the customer standpoint, we don't have any renewal guarantee choices. It's just a one-year deal. After the initial guarantee is finished, we have a lot of confusion with non-matching interest guarantees and surrender charges. A one-year guarantee within the seven-year surrender charge range gets a little confusing sometimes. From the financial side, problems become quite obvious. We have increasing disintermediation risk as the surrender charge wears off. After we're past a five- or six-year period, we have no more surrender charge. We're trying to do a good job setting a new rate, but we have no financial constraints. We have nothing to protect us when we're going out to set new rates. Competition gets difficult. Competition makes it difficult to have the kind of asset liability match that we would really like.

Another very big problem arises when we start looking at offering multi-year guarantees, i.e., nontax-deductible excess interest reserves on longer-term interest guarantees. This really precludes us from offering a good rate on the longer-term guarantee. If we look at the dynamic valuation law, the expectation for 1990 is that we'll wind up with 6.5-6.75% dynamic rates for these traditional products. So we're trying to offer somebody an 8.25% rate for five years, but since we're dealing with a 6.5% valuation rate, we're working with an 8% nontax-deductible reserve strain. If we're going to incur that, we're going to have to hold back a lot to get our return on equity.

What's the way around this? What can we do to have a solution that's going to work both marketing-wise and financially? The answer in my mind is a simple one. Offer products with increased disintermediation protection, and something good in return for the customer, for example, a 50 basis points higher interest rate. This is really the key to the whole thing. For a number of years, actuaries who were trying to get their management to work with the products that had the increased disintermediation protection were only talking about that side of it. It's very difficult to go in and tell the marketing Vice President, "You're killing us with the exposure under the product. Our company can't withstand the increasing interest rate risk." What's the marketing guy going to do about that? He says, "You've got problems, I've got problems, too. Go away." Let's look at it in a different way. If we go in and tell the marketing Vice President, "I want to talk to you about some pretty good stuff. I'm going to make life easier for you. I want you to be able to go out and offer the agents and their customers an extra .50 basis points per year." I think then the marketing guy will listen to us!

This is really what a lot of the disintermediation products are able to do. If you develop a product that encourages more persistency, you have more years to amortize your initial expenses, and you're able to pass on a little more because of that. If you're able to invest funds with less risk, you're able to put more good, more longer-term stuff into the portfolio, and earn a little bit more. If you're offering a product that has less risk with it, the same dynamic valuation law often will give you opportunities to work with a much higher interest rate, like 9.00%, for some of the products that have an MVA feature. If you do that, you don't have to worry about all of these excess interest reserves.

When you have the products that have more disintermediation protection, you don't have to hold as much assigned capital. One of the charts in a previous presentation showed how much margin you have to hold back per each 1% assigned capital. It was illustrating an MVA product for which 3% assigned capital made sense. The company wanted to make a 15% return, which would require about 41 basis points at 3%. This is a significant amount. But if you offer the book value product, then you put up 5% instead and that 5%, under the same kind of arithmetic, is going to require 68 points. So you can see there's a lot of leverage with all this.

With the different kinds of products that we'll talk about, you'll note that I have more of a personal preference for some rather than others, but I will try to go through all of them. Starting out with the book value cash-out feature still intact, we have the CD annuity; we also have the up-front persistency bonus product and we have the two-tier annuity product. Moving to variable features, we have the product with a variable loan rate (a new product that was discussed in the *National Underwriter* recently) and, lastly, the market value cash-out or MVA annuity products.

Before I turn to these specific products, I would like to give you another example to pin down the longer-term perspective. If we look at who the customer is, what the customer wants, all of the studies show that virtually all of our companies are dealing with an average buyer in the age 55- to 60-year-old range. This average buyer has a pretty decent amount of discretionary assets. The buyer gives us an average premium of $30,000. What happens to that at an 8.25% rate? After five years $30,000 grows to $44,600. After ten years, it grows to $66,000. After 15 years, it's grown to $99,000. My contention is that when we look at the traditional design with the five- or six-year disappearing surrender charge, we have a product that has really been oriented toward a person who just wants to get his $30,000 to accumulate to $44,000 and get out. I don't believe that that's where the customer is really at. These customers really have in mind going at it for a long time, getting up to the $99,000. We have to remember that these customers are not yuppies who need down payments for a house five years later. They're people who need to accumulate lots of money for the future. With that in mind, we can really work with the products that do emphasize more of the long term.

Let's start looking, then, at some of the specific products. The first product line is the CD products with book value cash-outs. In going through this, we have the same one- to seven-year initial interest guarantees, but there's an ability to do these same guarantees the second time -- which is a very nice advantage. We have a matching of the initial interest guarantee and the surrender charge period, which eliminates a lot of the confusion. In between these periods, we have generally a 30-day free withdrawal window for the policyholder to get out. The advantage with this design is that the surrender charge can be permanent. Another good feature is that these renewable cycles lend themselves to providing some renewal compensation with a little bit less up front. At the same time, though, there are some other problems that can't be ducked with the longer guarantees. We do get the benefit of a new surrender charge -- and many companies are hopeful that, despite an Illinois challenge to reserving, this surrender charge can be built both into the reserve for the initial guarantee and also for the renewal guarantees. However, we are still stuck with the 6.50-6.75% valuation rate that I mentioned earlier.

Another big problem that we highlighted a lot at the other session was some renewal persistency concerns. How many people are going to leave after the initial guarantee period? With this in mind, those of you who are looking at the CD annuity product should carefully distinguish between the one-year product versus a five-year product. They are totally different kinds of products. One speaker was commenting on his product that has one-, three- and five-year pieces to it. The speaker had noted that the renewal experience under the one- and three-year product wasn't particularly good. I think this product really has more to offer when you look at the five-year cycle.

The next product is the up-front persistency bonus design. This product will normally allocate 101-105% of the initial premium. Paul LeFevre was commenting before we started that there were some products that offer a lot more than the 105%; I think those are too gimmicky. The ones that are worth our attention are the ones in the range of 101-105%. How does a company provide this up-front bonus, the 101-105%? The way to cover this is to have it vest after a certain number of years. After the 101-105% is allocated to your account, the full rate of interest that the company is able to credit will be allocated to the full amount, but the policyholder is not going to be able to take that home unless the policyholder sticks with this through a vesting period, like years 6-10.

The really big advantage is that it shows the buyer that you can make out well if you stick with the deal for some amount of time. There are some issues under the standard nonforfeiture law. You especially need to make sure you don't run afoul of the prospective test. You need some reasonable grading into the maturity value. There are also some obvious disclosure issues. Companies that are offering this have to make sure that the buyer doesn't feel that he's getting additional interest up front. It's not a good idea to say that we're offering you an 8% rate, but because we've got 105% allocation, this is really a 13% contract. That's not the right way to do it.

The two-tier design is being looked at a lot by California, so be sure that it's done the right way. The two-tier design provides a substantial interest rate for ultimate annuitization and provides a lower rate for cash surrender. The rate differential is often greater in the early policy years. After a policyholder is around for a long time and some reasonable difference is established between the annuity rates and the cash surrender rates, a number of companies might have the two get a little bit closer together. Again, there are some significant equity and disclosure issues. Companies that want to offer this kind of product and make it meaningful should ensure that the annuity income rates are sufficiently competitive to validate the intended benefits.

This product warrants a lot of consideration. Unfortunately, too many of our customers cash in the chips at 10, 15 years down the road, when they're going to be paying a lot of tax. It's far more efficient and much better for the customer to convert the accumulation into some kind of annuity income. That annuity income is not going to be totally taxable because you're able to make use of the exclusion allowance. You'll get a deduction for the return amount that is related to the principal.

The next product I'll talk about is the CD annuity with restricted surrenders and a variable loan rate. Under this kind of a product, only certain types of cash surrenders are allowed, for example, a 10% partial withdrawal or a surrender in the event of a disability or being confined to a hospital for at least 30 days. The product that I'm referring to was discussed in a recent issue of the *National Underwriter*. Under this product, when the policyholder really needs some funds, a loan is available at the greater of the current Moody's rate or 1% over the guaranteed rate. This loan feature provides some real parallels to the MVA style. We're concerned with our products when interest rates go up. Under this kind of loan, the company gets a lot of the same protection that it gets with an MVA feature. If rates go up 3%, and policyholders want to take money out, that's fine; they do it through the loan. But then the policyholder is going to be charged interest at the current Moody's rate, which also has gone up 3%. When this is done, a company is then able to do reserving under the dynamic valuation rate on a Type B basis. Instead of the 6.5% rate, it can work with something more like 9.5%.

Let's discuss the market value adjusted products. In many ways, these products are just like the CD products, but we have MVAs. Here we can have a range of interest guarantees for up to 10 years. We're able to go a lot further, all the way up to 10 years, because we don't have reserving problems and because we have the full amount of company protection. A product can be either SEC registered under the 1933 Act (requiring a prospectus) or it can be nonregistered with some cap on the market value adjustment. This has been referred to as a "pseudo-MVA." A common form of it is a product with a MVA feature, very much like the MVA feature under the registered product, but with a cap on it, along the following lines: You don't allow the MVA, prior to the application of the surrender charge, to take the account value down to less than the principal amount accumulated at a nominal rate of interest like 3%. The surrender charge can then be put on top of that. This kind of interest rate cap allows products of this nature to get a nonregistration opinion from a number of law firms in this country.

There are really nice benefits from all this. There's disintermediation, reserve, and benchmark capital relief, and because of this relief, there is the ability to provide 50 basis points a year more than what you're able to do with the traditional product. That's pretty good stuff!

There are some state filing difficulties. Most of these are registered contracts, filed on a group basis. Some states will not sanction these products on a group basis, so you're not going to be able to get them through all 50 states; but you will be able to do them in most states. Incidentally, New York really has the very best statute providing for this product. In the case of New York, the product can be done on either an individual or a group basis.

I'll mention a couple of issues relating to traditional products. The first issue is the first-year interest rate teaser -- a no-win proposition! In the traditional market, especially with the one-year guarantees, companies are typically crediting at least 25 basis points more first-year interest than a level margin would allow. The average is probably a lot more than 25; 100 basis points is not uncommon. Obviously the feeling is that's the way to get sales. The problem is pretty obvious. What do you do if next year's new money rates are higher? Normally, it's going to be about a 50/50 bet. So if we're on the unlucky side of the draw, what happens in the second year? New money rates are higher. We can lower the renewal rate and alienate the agents and the clients or we can maintain the initial rates so that nobody gets upset, but in that case, we fall behind model profitability.

The second problem area is setting renewal rates after the initial surrender charge expires. This is really common to all of the products, the traditional products and the newer ones. We have to do a good job setting these renewal rates to minimize any 1035 transfers. To do this, the key with our investment policies is to be able to pay at least a new money rate after the initial surrender charge period. That in turn means that we need good matching to make sure that the assets roll over at or near the initial expiry date. The company also has to make sure that you're not using up the bulk of your crediting power in the initial cycle. To keep people with you, it's a good idea to hold a little bit in reserve after the first five years are up, and provide a little bit more to the people that you want to stay with you.

The very last issue is the CARVM reserving issue. I noted earlier that there is an Illinois challenge. The challenge that has been rendered by Larry Gorski, on behalf of the State of Illinois, is whether it's okay for a company to build the end of the policy-year surrender charge into the CARVM reserve calculation or whether you have to consider surrender at any time, which would be in line with New York Regulation 126. The biggest concern here is with regard to contracts that have cliff surrender charges, for example, 5-6% for five years, then a 30-day window to get out, or maybe nothing after that. Under the existing CARVM methodology, you're able to use the end of the year charge, but Mr. Gorski feels it isn't quite right to ignore what can happen a few days later. The answer to this one is unclear; it could go in either direction. One of the possibilities being considered is that the traditional CARVM reserve methodology would be allowed, but in exchange, the valuation actuary would really have to step forward and do sufficient cash-flow testing to justify the CARVM reserve or whatever other reserve would be used.

MR. PAUL H. LEFEVRE: I'm going to cover two areas. One is a product area that I agreed to cover briefly. The other one is that I'm going to attempt to overview the markets where the SPDA and the variable annuities are being sold. I'll talk a little bit more about the markets I'm familiar with and hopefully get some people talking about the ones that I'm not. And I'll also try to talk about some of the trends that we've been seeing.

The first area revolves around some product innovations that were a result of the aggregation rule and the inability of companies to sell combination or split annuities. The combination of a deferred annuity, normally with a five-year guarantee and a five-year immediate annuity, was an income sale, a very popular sale in the stock brokerage market. Its popularity came more from its simplicity than its real tax advantages. But it was a sale that allowed people to preserve their principal and receive tax-advantaged income over that period. And it usually involved a rolling-over time, although a lot of questions came up on that aspect. When the aggregation rule became part of the tax law, it was uncertain whether it applied to immediate and fixed annuity combinations. The uncertainty caused most companies to pull back from that market or use very heavy disclosure, which really closed down the market.

Many companies, ours included, quickly questioned if there was a way to design a single premium immediate annuity that, in effect, accomplished the same result. At least two products that I'm aware of did reach the marketplace. One of them has been quite successful. The first one is an immediate annuity with increasing payments. If there are any actuaries in the room, you can figure out what that does to the commuted value. It's a product that was designed with increasing payments, and the resulting mathematics that determined the increase of those payments was such that the commuted value of the remaining payments at the end of five years was exactly equal to the premium. It could have been greater, if you had the payments really going up. It was a 15-year immediate annuity product designed so that, at the end of 10 years, the commuted value was 75% of the premium and at the end of 15 years, it was zero. I'm not even sure if that product is still available. It did cause some discussion as to whether it was or wasn't an immediate annuity, and the exclusion ratio applied.

The second design which has had significant sales is a product that used a different approach. It is a 15-year annuity certain with a low guaranteed interest rate; the guaranteed interest rate for determining the payments is 2.75%. It results in a high exclusion ratio, more than 80%. The mechanism that this product uses is that it has a current declared rate and therefore, has excess interest credits. The excess interest is credited monthly and is used to purchase continuation of the payment after the 15-year period. After one month there is a small excess interest credit. That credit purchases a given number of months and fractional months of continuation of the monthly premium. So each month, the thing gets longer. Those additions of income have a commuted value. And the design of the product is such that, after five years, the commuted value of the remaining guaranteed payments, as well as the payments that have been added, are equal to the premium. I'm not sure, but I believe in addition, if the initial declared rate is continued, the product at the end of 15 years results in the commuted value of the paid up addition being equal to the initial premium. So it's a product that very much simulated the results of a combination annuity. It's a product that revolves very much around the projection of the interest rates and the continuation of the initial interest rate. It had a bailout feature that guaranteed, during the first five years, that if the declared rate was reduced below its initial level, then there was an ability to get out for your original premium. If you commute prior to the five years, you get out for less than the premium. So there are surrender charges. As an example, at a declared rate of 8.433% (to make these products work, you need more than one decimal point in the declared rates), the monthly payment on $100,000 would be $677 a month. If you multiply that by 12 just to make it easy, that's about 8.12% of initial premium being paid out annually. If you compound it, it comes out very close to the declared rate. The product had an exclusion ratio of 82%. Only 18% of the monthly payments were taxable. If the person makes it to 15 years, and continues to receive the payment, then the implication is that those payments are 100% taxable. That's the way tax disclosure was discussed.

I think a lot of you probably have heard about or seen that product. It is being actively sold in California in some banks, through one of the bank marketing organizations, and I know that at least two of the major firms have at least been taking a serious look at it.

On the distribution end, I'm going to concentrate on two major markets and talk a little bit about a couple of other ones that I think are out there. When we look at Keystone Provident Life's marketing, we break it up into three areas. One is major New York Stock Exchange firms. Another one is financial institutions, banks and savings and loans (S&Ls). And the last one is called "other." Other includes, for us, regional stock exchange firms (which have some differences from major stock exchange firms), financial planners, other life insurance companies (we do sell some of our products through the agents of other life insurance companies, with the knowledge of the life insurance companies, using the life insurance company itself as the driving force), specialty general agencies, and small broker dealers. The market that I don't know much about, and I just get a hint about when I look at magazines like *Life Insurance Selling* and *National Underwriter*, is a very aggressive market concentrated in the personal-producing general agent (PPGA) market and in portions of the tax sheltered annuity (TSA) market.

Starting with the major stock exchange firms, there have been many recent trends in what has been a very big market for SPDAs. The major thing that I would like to point out about that market is the move toward proprietary products. Shearson, Merrill, Dean Witter, and Pru Bache all either own or have in their family, life insurance companies that provide SPDAs and in most cases, variable annuities. In some cases, these products are available almost exclusively through one firm and in some cases, to other firms or across other distribution forms. However, that doesn't mean that, for example, Dean Witter brokers only sell Northbrook products or Allstate products, because stockbrokers have to have an element of independence. So they need other carriers. The stockbroker needs to have available more than just a proprietary product.

So there is an opportunity for what we call second-tier products to be in the system. We are a company who is in every major firm. We have a selling agreement with every one of the major firms, but that doesn't mean we do mega millions of premium with each one. I think that we did $100 million with one firm last year, and we did as little as $9 million with the lowest of the major firms. Three years ago, it might have been about the same, but the firms might have been reversed, so there is a lot of movement.

The other thing is that, compared with what I'm going to say about the bank market, the stock brokerage market is much more driven by the tax benefits of the annuity product. That has a couple of implications. Number one, and this was my personal opinion, the rates that are driving SPDA rates in that marketplace are SPDA rates more than any alternative rates such as Treasury rates, CD rates, or anything like that. Second, the way that money moves, other than normal things like death, seems to be via 1035 exchanges. In other words, the preservation of the tax benefits of the original sale are very important. Money still moves, but it's moving from one company to another. I sign a lot of checks. When I sign checks on annuity surrenders, I notice that most of them are going to other companies, not to individuals.

I noticed a little earlier this year, when I looked at what we were paying on our annuities as a first-year rate, that it was the lowest rate we had ever paid since we had been in the business, and we've been in the business since 1983. The annuity rates that existed toward the end of 1989 were, for us, the lowest we had ever offered. In general, margins in first-year rates were coming down. That's what Michael was alluding to, the idea of subsidy or hyping the first-year rate was really sneaking in quite heavily. Because SPDA rates drive themselves, it was sort of a circular thing. And there were reactions. I think companies, either consciously or semiconsciously, were reacting to the lower rates, by hyping the first-year rate a little bit more, or just inadvertently setting higher first-year rates.

One of the reactions to that in 1989, in the brokerage market (it occurred a few times before), was the special offer. There were significant, but not overwhelming, numbers of special offers last year. The features of the special offer in a major firm, if it's specific to a single firm, are things like this. It is available until $x million has been sold. For example, the brokers are told, "Here is a special product from XYZ company. It is available until they do $50 million, so you better get out there and do it quick." They usually involved very competitive rates. One had a very aggressive rate, but it could only be used for 1035 exchanges.

Another firm used a 50 basis point bailout with a fairly aggressive first-year rate. The bailout was used as an implied disclosure about how much the first-year rate might have been subsidized or hyped. And the bailout was also used as a slight implication of a five-year guarantee. It was a cheaper way of dealing with another trend that had occurred, which was looking for long-term guarantees without having to have the strain of a five-year guarantee. And not only that, having a higher strain than a one-year guarantee, but having it deductible. Some firms, one in particular, seem to be going in the direction of using special offers quite often. There was one in mid 1989 that involved a full page ad in *The Wall Street Journal*. "Special offer, limited time, limited amount. See your broker."

The business written by New York Stock Exchange brokers is controlled by the broker. It is not controlled as much by the customer. The broker in these major firms is, in a sense, controlling for his or her customer a book of business, which includes investments as well. It is his or her livelihood and when you start talking to the customer, and trying to influence the customer's behavior, it's going to be very difficult.

With regard to first-year rates, I think there is a trend toward a bit more responsibility. I've seen it. If you are subsidizing your first-year rate, I believe you can lower it the next year, even if rates have gone up, if the broker realized it at the beginning. There has been a trend and it's developed more on the bank market which I'm going to talk about next, and it's developed in different ways. It is a trend toward disclosure of a first-year rate bonus. And I think it's responsible and intelligent on the part of the company because it does eliminate or at least temper what Michael was talking about. Some companies have gone so far as to get signed disclosures from the applicant that say, in effect, "I realize that the first-year rate contains an extra 100 basis point bonus." I don't think that's necessarily bad. It's a lot less dangerous than just paying it and not saying anything and praying for rates not to go up. The other thing I think some companies have been doing, and I think it's also intelligent, is to put a little responsibility on the broker on that kind of approach. To actually carry a commission charge-back through a period when the rate renews, to make it clear to the broker that he has to sell that aspect or has to disclose that aspect, because if he doesn't, and the person is angry enough to surrender, then he's going to lose.

Estimated 1989 SPDA premium in the institutional market (the bank market) is $7 billion. Top five companies: $3 billion. Top ten companies: $4.1 billion.

There are many SPDAs being sold in financial institutions. The recent trends in that market are that banks are coming into the market. There were a lot of prohibitions or a lot of problems with banks actually getting into almost any insurance market. There was, in a sense, a limitation to 12 so-called grandfathered banks across the country and it was the thrift industry, S&Ls, that were selling insurance products, specifically SPDAs.

The combination of a Controller of the Currency ruling that indicated that banks could sell insurance products, and some State actions, very recently in Delaware and in Florida, seem to be opening up the banks to the selling of insurance. In Florida there was just a very slight window open and it's only for annuities. The wording isn't really out yet, but my recollection is that if national banks have the ability to sell annuities in Florida, so will state banks. Don't quote me on that, I haven't even seen the law.

In that market in general, there are a couple of very big differences from the brokerage market. Number one, believe it or not, it is not as tax-driven. The people in our customer service department who handle conservation are getting the impression that many of the customers don't even know about the tax benefits. They don't even consider them. The rates are more driven by comparison to CD rates. When you lose a lot of this business, you don't lose it to a 1035. People just roll it into a CD and if they do it in one or two years, they're not losing that much taxable benefit. You have to be very aware of CD rates.

Second, the policyholder is much more in control of his own actions than in the brokerage market. In general, the customer is dealing with the bank. Customers walk into the bank, see CD rates, and look at what they bought that might or might not have a lower rate.

We have found that not-taken rates (returned policies in the first month or two) are almost not even noticeable in the stock brokerage market, and they are very noticeable in this market. A lot of people and a lot of companies have tried to solve this. It's been blamed on slow delivery, but they've tried to solve it by using quicker delivery, field issue, and instant issue, but basically it seems to be, "What is this thing with all these pages? What did you sell me? What did I buy? Where's my CD certificate?" There's a little bit of problem with that and I'm talking about not-taken rates of 4-6% in some banks.

How does this market work? It's a market with a large customer base. Banks, in general, have a very low-moving decision-making process. Once they make the decision, they want to move fast. If you think insurance companies have committees and Vice Presidents all over the place, banks make us look like nonbureaucratic, efficient organizations. Normally, there are a few considerations. A new organization is going into the business. There are roughly three ways they can do that. One is using bank personnel in some manner. They're going to train their own personnel to do the delivery, selling, or whatever you want to call it. One approach is to use tellers and another is to use so-called "platform people." Platform people are the people that you talk to when you go into the bank to get a car loan, or if you want to discuss a mortgage or open an account. Other approaches involve the use of outside marketing organizations who do the selling. In those cases, usually tellers serve as referral only. The annuity man is there, every Wednesday afternoon, or appointments are made. But in most cases, either the insurance company through its own captive marketing organization, or in most cases, an outside bank marketing company is involved in one way or another, and installing, training, servicing, getting them into the business.

As these program and banks mature, then you're faced with the possible evolution of, "We do it all ourselves." The insurance company, like the brokerage firm, becomes a manufacturer and provider of products. And in a real mature bank organization, normally there would be more than one product offered, through a captive broker, dealer or agency, etc.

We seem to be noticing, during the penalty period, better persistency with the stockbrokers than the financial institutions. People with banks tell me that's because we wrote in the thrifts and only recently in the banks. When we look at the bank business, it's going to be great. When I'm talking about persistency, I'm talking about very crude, calendar- year decrements. In the noninstitutional market, the implied lapse rate has run as high as 4% during a penalty period, and then as low as 2%. Our single premium whole life business sold in the brokerage market has been in the 2% range. The early returns on the institutional business imply numbers in the 5-7% range. We do not have a lot of business in the stock brokerage market that is out of the penalty period, but what we do have is exhibiting surrender rates in the 6-11% range.

In the market that I call "other," we're finding that there is a slightly different compensation structure required. The stock brokerage market has probably got the lowest commissions. We feel that the broker/dealers are somewhere in the middle, and that's a market where quite a bit of annuity business is being sold.

Here's a story to give you an idea of some things that happened in the stock brokerage market. One of my wholesalers was bemoaning to us that we lost one of our top producers, because our renewal rates had been too good and it will impair his ability to move the business to another company at the end of the penalty period. We have been exposed to 1035s coming from other sources, using products like the one that Michael described; products such as two-tier annuities that have some kind of implied bonus in them. The approach is that this bonus more than offsets the surrender charge that you're going to incur by moving the business to these companies. Moving business from one company to another, using that type of approach, either we will pay your surrender charges or don't worry about the surrender charges is just emerging.

MR. NATHAN A. GREENLEE: I have heard a lot of things about reducing surrender charges, reducing front end loads, and eliminating front end loads. One thing I haven't heard is anything about the SEC Rule 12(b)(1), which puts a limit on back end loads. It applies to mutual funds, but variable annuities are pretty much the same animal, packaged a different way, sold a different way. I'm wondering if anybody has heard of any way that that's affecting product design for variable annuities, especially since a lot of us do sell through brokers and they are going to be subject to this ruling.

MR. FENTON: A 12(b)(1) charge is typically found on a mutual fund. It's an asset-based distribution charge, in addition to a front-end load. Variable annuities do not have 12(b)(1) charges, they have other charges, such as the distribution charge, which is similar to a 12(b)(1) charge. A few funds did try and institute 12(b)(1) charge on the variable annuities, but the SEC has not permitted them to do that. To the extent that the SEC is cutting back on mutual funds, we could see some efforts in the future to reduce the M&E risk charge to levels found on other types of investment contracts, but I think it's pretty well set at 125 basis points for now.

MR. JAMES R. THOMPSON: I have some questions on the TSA marketplace. One deals with premium persistency. These dual interest contracts can be disintermediated against, not through a 1035 exchange, but rather through simple cessation of premium. I haven't been able to see any industry figures on this, and it seems to me to be a fairly obvious vulnerability. Maybe they will turn into five-pay contracts or something when people see what's going on. Does anybody have any experience? The second question deals with the definition of these two-tiered contracts. Mike's definition, which I think is a California definition, deals with the dual interest rate, but up in Washington and Oregon, they're using are perpetual surrender charge and they disallow such contracts. I'm just wondering whether there's going to be a trend of that going through the NAIC?

MR. WINTERFIELD: I was deliberately talking about the two-tier structure with regards to the SPDA market, rather than the ongoing premium TSA market. I would agree that you could have the disintermediation problem with new premiums if a company starts out the two-tier and isn't doing a good job year after year.

I'm looking at the SPDA market quite differently. There aren't that many companies actually doing the two-tier. I look at the two-tier product as something that's just evolving and I felt it worthwhile to look at this as a concept. There's validity in having the possibility of a significantly higher accumulation down the road by going the annuitization route rather than cash surrendering. I think the evolutionary process is going to cause the products to be changing the next year or two with regards to what these differences are; we are just at the beginning of this.

MS. LINDA S. NEED: This is more a comment than a question. Paul did a great job of describing one of the new products that's on the market as an alternative to the combination annuity. The one thing he didn't tell you about is that there are some real conflicting tax opinions on that product. The company that is selling that product has a tax opinion that says the exclusion ratio can be based on the low guaranteed rate and that everything is legitimate. There are several large law firms that have said that maybe that's not true. I would just urge you, if you're looking at that product, to talk to your own attorneys.

MR. PAUL T. BOURDEAU: I have a comment rather than a question. Maybe someone could react to it. It's relating to the first-year bonus teaser rate. Five years ago I was really bothered by this and we really looked at it, to the extent that we looked at the *Congressional Record* because they had a hearing on adjustable rate mortgages, which are a direct parallel. Your mortgage rate is 8% the first year and it's 11% the next year. They were going to legislate against it, and basically you've got a Congressional okay on it. It's done throughout the country. I think the issue on the bonus rate is that the market forces are going to force you there. I think you have to spend your time possibly on disclosure and possibly on whether you're going to keep it in the 50 and 100 basis points range or whether you're going to go the ridiculous 500 basis points. Companies might get some comfort in knowing that every S&L and mortgage company in the country is using the teaser rate.

MR. LEFEVRE: The acceptance of the disclosure of the "teaser rate" in the institutional market has always relied on or has been really involved in just what you're talking about. They're used to it. I feel that in a sense it is a good movement if you properly disclose the fact that there is an element of the first-year rate that is a premium or gift. However, there are companies out there that have been using first-year rate subsidies of as much as 200-300 basis points without disclosure. I don't think that's responsible for the industry.

MR. WINTERFIELD: I'm pleased that some companies are giving a certain amount of disclosure. It's obviously better than no disclosure, but my feeling would be that if you're going to give a teaser and then you're going to disclose that it is not going to continue, then it's just not worth the effort! If you're going to say you've got a 9% rate, but remember this is 100 points higher than it's going to be after that, I feel that the company will do better to offer a straight rate like 8.25% that you can live with all the way through.

MR. LEFEVRE: In some markets, there's been an interesting evolution of the teaser rate. It's almost been a negotiation between the manufacturer and the distributor. And a lot of times it has involved the reaction to lower sales and give up of commission and if you tried to take, let's say, a 50 basis point give up in commission and spread it across the whole product, it's going to give somebody five or six basis points, but if you then just raise the first-year rate, disclose it, etc., it has evolved that way as well. As long as it's responsible, I don't have a problem with it, because the customer will always have the benefit of having had that higher rate for the first year. The policyholder will end up, when he finally surrenders the contract, with that little extra bit of interest that he wouldn't have had.

MR. JEFFREY K. DELLINGER: My question pertains to the guaranteed minimum death benefit (GMDB) for deferred variable contracts that you spoke about earlier. Could you speak to the cost of the benefit? You have a 1.25% asset charge and part of that must go toward the cost of this GMDB. Any feel for what that cost is?

MR. FENTON: That is always the big question on variable annuities: what is the cost of the GMDB? I don't think there's been a lot of testing done in the industry on that. Some limited testing that we've done suggests that the expected cost is fairly low, in the range of 5-10 basis points, but there is a wide range of costs over different scenarios. It would depend, of course, on the types of funds that are being offered and where the money is going, but I think that's an area that needs more work in the future.

MR. LEFEVRE: On that issue, we've attempted to hold fund dependent reserves for that benefit. We hold a larger reserve for the stock fund than we do for money market fund. The basis for doing that is obvious. We don't use a very scientific method, we just rely on the basis of the funds as sort of the indicator of the potential volatility.

MR. ERIC SHAWN HENDERSON: I just want to follow up on that last question. You talked about a cost for the level GMDB. What about the costs for the 5% increasing benefit that a lot of companies seem to be going to now?

MR. FENTON: It's larger.

MR. LEFEVRE: I don't know if we could quantify the number on that, but obviously it would be larger. I don't think there would be a significant additional cost that you'd have to hold, but have to reflect in your pricing, but there probably would be some.

MR. THOMAS P. McARDLE: If a company has an initial interest rate guarantee on its fixed account, how does it protect itself, when the client transfers money out of the fixed account and brings it back in to get a higher interest rate guarantee?

MR. FENTON: In some cases, you may limit your ability to transfer money until the end of the guarantee period. Of course, the big concern is to make sure that money doesn't go out of the fixed account when interest rates have risen and your bonds supporting that are underwater. A typical feature is to limit it to a 25% of the account value withdrawal and only at one time during the year, so as to minimize anti-selection. There is one product out there with a three-year guarantee where there are no withdrawals allowed during the three-year period to protect against anti-selection. Theoretically, they're purchasing assets to match that particular guarantee.

MR. LEFEVRE: The one thing that we did in a product that we're not selling anymore is that we had two elements to your question. One was transferring money out. We did not allow transfers during the first policy year, which just set a tone. The main tone was to keep market timers out. The other feature that we had to prevent the rate arbitrage thing you're describing is that if somebody transferred money out of our fixed account, it just closed the door. No money could be put into that fixed account for six months after that transfer. So it was a very strong statement, but it prevented the flip-flopping that might have resulted.