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INDIVIDUAL LIFE PRODUCT UPDATE

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Recorder:	SANDRA POTASKY

- Variable product update
- Term product update
- Market share trends

MS. SANDRA POTASKY: Erica Querfeld is an ASA and an analyst in the product and profitability research division at Life Insurance Marketing and Research Association (LIMRA). Erica began her insurance career with Monarch Life and she joined LIMRA in 1988 as an associate analyst. She advanced to her present position in 1990, in which she is responsible for conducting research projects involving persistency, product issues, and compensation for the Association's member companies. Erica is a graduate of the University of Connecticut, and she is going to speak on market share trends.

MS. ERICA B. QUERFELD: The 1980s were a period of rapid life product development, and this seems to be continuing into the 1990s. I'm going to discuss trends in life insurance sales for the following products: whole life, universal life (UL), term insurance, variable universal life (VUL), and variable life. I will also discuss trends in product design and product lapsation. In specific, I will discuss the following products: second-to-die, first-to-die, term insurance, and blended products, which mix term and permanent insurance together.

But first, let me provide you with a breakdown of the current life insurance market based on a new annualized premium (Chart 1). As you can see, for the past five years the product mix has been quite stable. Whole life continues to capture the largest share of new premiums. Its market share in 1991 was 55%, which is down from 78% in 1981, but up since 1986. Universal life's market share peaked in 1985 at 38% of the market. At this time, replacements were a big factor, as were higher interest rates. Median credited interest rates on universal life were around 11%. By 1991, ULs market share was 26%, and interest rates were around 8%. Term insurance has remained relatively stable since 1984, fluctuating between 11% and 13%. Since 1988, variable life's market share has been about 1%, while the market share for variable universal life has hovered between 5% and 7% (Chart 2).

As a whole, variable life products, during the first six months of this year, led the way in new sales. In fact, new premiums for variable products increased 63% over the first half of last year. This growth is partly a result of the decline in interest rates. In July of this year, median credited interest rates were 7.8%; while in 1985, when UL peaked, interest rates were around 11%. When you look at market share by face amount, the distribution of products changes (Chart 3). Term insurance represents the largest portion, and together, UL and whole life make up half the market share.

CHART 1
LIMRA's Industry Estimates of Ordinary Life Market Share
(Annualized First-Year Premiums)

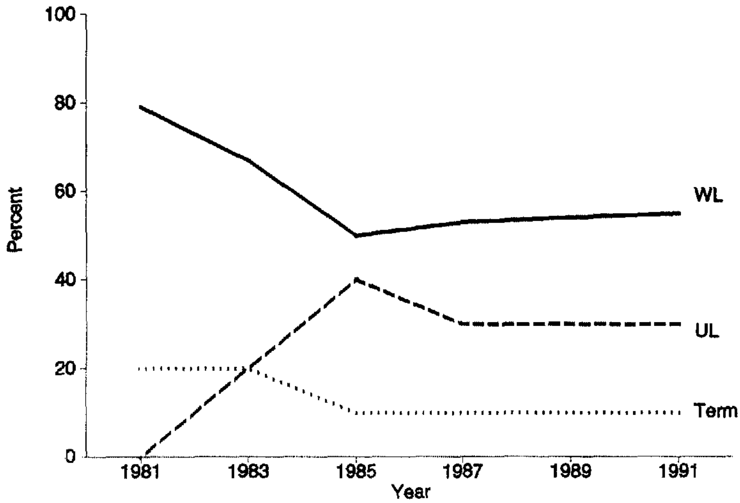


CHART 2
LIMRA's Industry Estimates of Ordinary Life Market Share
(Annualized First-Year Premiums)

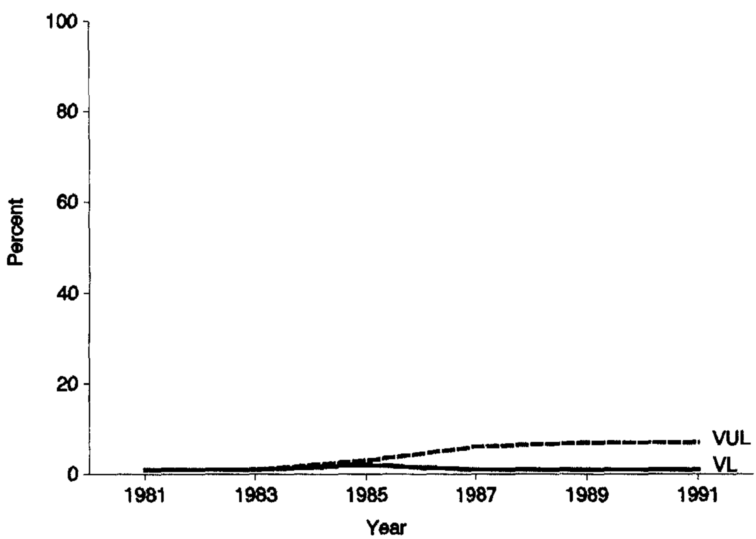
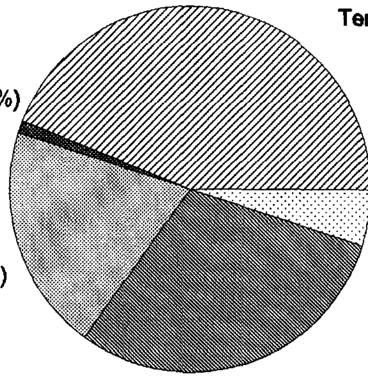


CHART 3
1991 Market Share by Product
(Face Amount)



A product that has been receiving some attention is second-to-die life insurance. For the first six months of 1992, new premiums were up 27% over the same period last year. However, if you look at the last six months of 1991, new premiums have actually decreased a little bit, about 3%. The average face amount sold was $1.1 million, which is continuing a trend downward. In 1988, the average face amount was about $1.4 million. The average premium per policy is around $19,000. Second-to-die insurance is accounting for an increasing percent of companies' total life sales. Most companies sell it as a separate policy, but some are selling it as a rider. Whole life is the most popular form, followed by universal life. Target markets for this product are estate planning, the affluent, business insurance such as key persons or small business owners, buy-sell agreements, the mature market, and married couples.

This growth in second-to-die sales has sparked interest in a companion product, first-to-die insurance. In 1991, new premium more than quadrupled since 1990, partly because new companies were entering the market. The average face amount was around $180,000, while the average premium was around $3,000. Most first-to-die products have a minimum face amount of $25,000. Universal life is the most common form, the maximum number of lives that can be covered by one policy ranges from 2 lives to 11 lives, but usually the number is two. The target markets for first-to-die are the business insurance market, followed by estate planning and dual-income markets.

Table 1 shows that the next product I will discuss, term insurance, has gone through some dramatic changes. Yearly renewable term is still the most popular type of level face amount term insurance in the United States. However, more companies are offering products with larger premium increases. In Canada, five-year term and 10-year term have made the biggest impact. Here are some common characteristics of yearly renewable term (YRT) products. Minimum issue ages range from 15 to 20. The maximum issue ages tend to range from 60 to 70. They're renewable to age 100, convertible to age 65 or 70, and the minimum face is usually $50,000 or $100,000. YRT is still the most popular form of term insurance, but we're seeing premium increases every 3, 7, 15, or 20 years more frequently.

TABLE 1
Renewable Term Market Share by Percent of Policies

Length of Premium Payment	Market Share	
	1985	1991
1 year	57%	57%
5 years	13	22
10 years	8	10
Other	22	11

Five-year renewable term has realized the largest growth in market share on the term market. In 1985, it represented 13% of the market, and then six years later, it was up to 22% of the market. Attractive features of these non-YRT products include: the premiums stay level longer; the agent compensation is similar; and lapse rates tend to be lower. Initial premiums, as expected, are higher for these non-YRT products (Table 2).

TABLE 2
Renewable Term Characteristics

Length of Premium Payment	Premium per $1,000
1 year	2.30
5 years	4.00
10 years	3.70

The 5-year term and the 10-year term are paying over 1.5 times YRT products. The average face amount for these YRT products is $169,000, and the 5-year and 10-year average face amounts are over $100,000. The product development of term insurance during the late 1980s is also appearing in the 1990s. An area that continues to be a problem is the persistency of term insurance (Table 3).

TABLE 3
Term Lapse Rates

Policy Year	YRT	Other Level Term
1	15.7%	15.4%
2	18.0	18.0
11+	10.4	8.9

Lapse rates for the non-YRT products tend to be lower than those for YRT products, especially in the renewal years.

How do term lapse rates compare to whole-life lapse rates? Long-term lapse rates for YRT tend to stay rather high through policy year 10, while in comparison, the whole life lapse rates decrease as the policy years increase (Table 4).

TABLE 4
Lapse Rates for Whole Life & YRT

Policy Year	Whole Life	YRT
1	14.5%	15.7%
2	11.3	18.0
3-5	7.1	16.7
6-10	7.4	12.2
11+	6.1	10.4

This subject of lapses brings up a frequently asked question. What is the average life of a policy (Table 5)? If you take both lapses and deaths into consideration, the average life of a whole life policy is longer than for a term policy. But this is not to say one product is better than another. In fact, term may be addressing the needs of clients more appropriately.

TABLE 5
Illustration of the Expected Life of a Policy

Issue Age	YRT	Whole Life
25	5.8	8.5
35	6.8	9.9
45	6.5	12.0
55	6.2	12.9

A product that combines term and whole life together is a blended life insurance product. This product blends permanent insurance and decreasing term coverage together.

Some companies allow the policyholder to choose the mix of permanent and term, while some keep the blend fixed. Typically, part of each year's premium is used along with dividends to gradually reduce the term portion, replacing it with paid-up additions (PUAs) while keeping the premium and the face amount level. Some products allow extra premiums or dump-ins that could increase the face amount, shorten the premium payment period, or accelerate the term replacement. These products blend full-commission, whole life insurance with other lower-cost products. The term insurance portion carries a similar commission as the whole life; sometimes it is slightly lower, but it's much cheaper. The PUA portion, or the dump-in riders, on the other hand, carry a smaller commission, about 3%. LIMRA is currently collecting data on companies that are selling this type of product. We've heard from over 100 companies, and 22 have indicated that they are selling this type of blended product. When we asked the companies who are not selling it, if they have considered offering a blended life insurance product, 10 are planning to offer one in the near future, while 15 are thinking about it. That has been a brief overview, and afterwards I'll be happy to answer any questions.

MS. POTASKY: Next we're going to hear from Mel Feinberg. Mel was born and raised in Brooklyn, New York. He attended Brooklyn College and graduated in 1969 with a bachelor of science degree in mathematics. He joined New York Life's actuarial program shortly after graduation. Mel became a Fellow of the Society of Actuaries in 1976, and a Chartered Life Underwriter in 1987. He is currently a vice president and actuary in the individual life department. He is responsible for product management, illustration software, and individual life products and reinsurance administration. Mel is going to give us a further update on term products.

MR. MELVIN J. FEINBERG: I'll give you an idea of where New York Life is in the term market. Based on 1991 sales, New York Life was the third leading term-producing company. Our face amount was $24.5 billion, and premiums totalled $48 million. So far this year, it looks like we're going to exceed those amounts. In 1991, we were selling two types of term products. One was an annual increasing term, which used a select-and-ultimate premium design. The other was a seven-year level term, where the premiums were level and guaranteed for the first seven-year period. Upon renewal, at the end of the seventh year, another seven-year-level period began, and premiums were guaranteed again for that seven-year period. Some other companies used different designs on the level-term product. After the first level period, the premium structure reverts to an annual increasing premium structure. For our 1991 sales, we sold about three-quarters of our business on the annual increasing premium, select-and-ultimate premium design, and the balance on our level-term design.

There's an insurance administration service called USA that did a survey of several hundred chief marketing officers, asking what are the hot products right now. Term insurance really was kind of down near the bottom. Only about 8% of those chief marketing officers felt that term insurance was going to be a hot product in the near future; but when the same group was asked, what are your product plans in the near future, a little over 30% said that they were planning to introduce new term plans, or repriced term plans. So I think, rather than saying there's many of motion in the term market, perhaps the better term is commotion. There's a lot of moving around. I don't think that there are really any new, revolutionary ideas in the term market.

Let me give you an idea of the kinds of issues that we wrestled with when we redid our term portfolio over the last year or two. I mentioned that we had two term products selling in 1991. We introduced a ten-year reentry term product early this year, which has guaranteed level premiums for the first ten-year period. After ten years, the policyowner has a choice. The policyowner can reenter by qualifying for an underwriting classification no worse than the underwriting classification at issue, and then the premium structure begins as a new issue-type premium, again guaranteed for a ten-year period. If the underwriting standards were not met, then the premium structure reverts to an annual increasing premium. Clearly, that class of people who did not reenter or did not convert or lapse would be a very seriously impaired risk population, so our premium structure really takes off after year ten.

Of the top ten companies selling term insurance these days, seven of them have three or more term plans. Typically, there is an annual increasing premium term plan, either a select-and-ultimate or an attained-age product, and a level-term plan. There are two companies out of the ten that have only one plan. In one case, it's an attained-age term, and in the other case, it's select-and-ultimate. There is no company, at least among the top ten, that has both a select-and-ultimate and attained-age product.

Each year, Tillinghast does a very extensive term insurance market study. The 1991 study surveyed 136 policies, and maybe 40 or 50 companies in total. The most common plan among those companies was a level-term plan. The most common plan after that, of course, was an increasing-premium term plan. What is surprising, or maybe not so surprising, based on the information that Erica just gave us, is attained-age term was more common than select-and-ultimate term. Select-and-ultimate term has been around for a while. At New York Life, we first got into the select-and-ultimate term market using indeterminate premiums, at the end of 1981. We kept that product in our portfolio with repricing over time, until September of this year.

Just last month we introduced a different version of our annual increasing premium term product. We moved away from a select-and-ultimate design over to an attained-age design. This raised the going-in premium, but it leveled out the increases over time. With the select-and-ultimate that we had in the past, we had very poor persistency. I wish it was as good as the persistency that Erica showed before. Generally, by the end of the third year, we had more than half of our business off the books, and that was primarily through lapses, which led either to reentry in our own product, or reentry into another company's product. Clearly, we were not making any money with that kind of policy structure, and probably very few companies in the industry were making money. That's really the genesis behind level term. Select-and-ultimate term was just not a product that was structured for most companies to make money on. It's a little early for us to tell whether it will have any effect on our sales. It probably will. There probably will be some downturn in our sales, but it should be more profitable business and more persistent business, so we feel that's the right way to go.

I spoke with some of our leading term producers – New York Life agents. We have a pure agency force. They've told me that, generally, they like the product design, but what they like most is the increasing premium. We're a company that encourages term conversions to a permanent plan. For most of our plans, we have a conversion credit, which is an incentive for the policyowner to convert to a permanent plan. For our annual increasing premium plan, the credit is 10% of the permanent premium. For our level term plan, the credit is a percentage of prior term premiums that have been paid. Our agents like the fact that premiums go up slightly so they can come back and make a presentation to the client to move over to a permanent plan. And they like the conversion credit, because that's just one little extra twist that would encourage conversion. Although, interestingly, they say the amount of the credit is not critical. Just having some type of dollar incentive is something that they encourage and emphasize in their sales process. I looked at the policies that are in the 1992 study of Tillinghast, and about half of them don't have any conversion credit whatsoever.

For those that do offer a conversion credit, about 30% based their credit on the term premiums that have been paid. It may be a refund of all term premiums paid in the prior year leading up to conversion, or it may be some percentage of premiums paid over the lifetime of the policy, which is the way our seven-year term policy works. The balance of the conversion credits offered are generally of a form that's a fixed amount. It may be a per-thousand of death benefit amount capped at a certain maximum. It's interesting that one state, New Jersey, requires that you actuarially justify the conversion credit when you file your term plan. You have to justify that your conversion credit has some direct connection, generally based on the level of underwriting expenses that you're going to save. Perhaps this is going to be a trend, but for now, only one state requires that demonstration.

In connection with these level term plans, there are a couple of issues that are worth bringing up. We now have a couple of companies with 20-year, guaranteed level-premium products. As pricing actuaries, it's kind of difficult to imagine how you price something like that. You certainly could price it on current assumptions, but those assumptions are going to change very quickly. Some things come along that are real surprises, like the deferred acquisition cost (DAC) tax of a couple of years ago. If you had a policy with a 10-,15-, or a 20-year guarantee and you were hit with that kind of tax, how are you going to recover it from those policies? We have no idea what's going to come along in the next 10, 15, or 20 years. As a pricing actuary, a 20-year guarantee makes me a little nervous.

Another interesting aspect of this that one of our leading term producers mentioned to me is that he finds it easy to sell against a long-term guarantee product. The approach he used with the client is: If you're not really sure how long you're going to need your term insurance, you may be paying more up front than your actual cost should be. Yet, what would happen when you lapse your policy? You don't get anything; there are no forfeiture benefits. I think, if we get into term products with long-term guarantees, if they don't generate cash values, there may be some consumer-generated push to liberalize minimum nonforfeiture values.

Table 2 showed you the average premium for these level-term plans. You may have noticed that the average premium on a ten-year term plan was lower than the five-year term plan. Of course, you're mixing in different policies and different companies, and so the average is misleading. But I think it demonstrates the issue, and one that we had to wrestle with very seriously. The more term plans you have in your portfolio, the more difficult it is to get the premiums to line up. It's difficult to get premiums to grade within the plan itself. Should a ten-year term plan that has a conversion right be more or less expensive than a five-year term premium that doesn't have a conversion right? Or maybe it does, but it has an incentive credit. Things really get confusing, both from the policyowner's point of view and from the agent's point of view. And the fact that I've seen quite a few companies having three, four, or even more term plans in their portfolio makes things a little bit confusing. Perhaps the trend might be to streamline the term portfolio in the future.

If I had to pick the area with the greatest opportunity for innovation in the term market, it would be the riders that are on permanent policies, and in some cases, on the term policies themselves. With our seven-year, level-term policy, we have a seven-year, level-term rider that can insure other family members, a spouse or children. And that seven-year term rider is available on our permanent plan also. That really fits into our marketing focus, and I'll explain that very briefly.

We have three term plans, as I mentioned. The annual increasing term plan, which is now an attained-age plan, is there for the conversion market. It has the features that our agents like to encourage conversions. It has increasing premiums and a conversion-incentive credit. So we think that corner of the market is covered: people who are looking for short-term needs, maybe to meet a limited-premium commitment and then convert over to permanent. The seven-year level plan is targeted more towards the young family, maybe with young children. By selling this term policy with the riders insuring a spouse and children, it makes a nice little term package which should really improve persistency and help out in our pricing. It's one thing for the policyowner to lapse a policy that covers just himself or herself, but when the spouse and children are covered, and there are conversion rights in those riders, it's less likely for a policyowner to lapse. Our ten-year level term, because its reentry after year ten, is probably going to be sold in the business market, where there's a desire to cover some short-term business need. This plan offers a level commitment that the company can budget and plan for with the guarantee.

With these three term products, we think we have the market covered. I think the fact that we have term riders that insure other family members is somewhat unusual in the term market. It's obviously more common in the UL market, but it's something new for us in the term market.

Erica mentioned the composite-type product, the combined product. We call it dividend-option term. This is a mixture of decreasing term insurance and paid-up additions, where the term insurance and the paid-up additions offset each other so that you can keep a level total death benefit. One of the uses, as Erica mentioned, is to minimize the going-in premium per thousand, in order to get at least some permanent insurance into the package. The way our agents sell it is they explain that it's more efficient than buying term insurance, because you are paying for that term insurance internally with untaxed dollars. On our whole-life plan, our composite term works by paying out-of-pocket for five years, after which dividend values, internally, pay the term premiums. It's cheaper and more efficient than paying out-of-pocket for term insurance. Our term rider doesn't have a conversion right, and we've been told that's really a competitive deficiency, and we're going to remedy that, we hope, next year.

There are quite a few customers, generally the sophisticated ones, that look at this combo term rider as having a risk element in the product. When they buy the permanent plan with the whole life, for example, they know they will never have to pay more than that guaranteed whole life premium every year. But this combo term has a current and a guaranteed maximum scale, with an indeterminate premium. They buy the product but the company could raise those term premiums. Having a conversion right gives the policyowners a bit of an escape clause. If those rates go up and the policyowners begin to suspect this may be a lot more expensive than they initially thought, they could convert to a permanent plan.

Because there is some kind of suspicion in the market that this term insurance has a risk element, people are asking us to illustrate different term rates within this composite policy. Typically, in the entire term insurance market, including term riders, illustrations show only the current term premium and the guaranteed maximum term premium. I think that's generally status quo for term policies. But within term riders, we're being asked to illustrate alternative term rates internally. I think that's going to be a trend, and if any of you are involved with illustrations, or software testing, I think that is something that's going to come very soon.

There was a panel discussion at this meeting, which I wasn't able to attend, but with someone from the IRS who was talking about 7702A, modified endowment implications, for this combination term rider, and the fact that the IRS is leaning towards treating this as a qualified additional benefit. For those companies that treat it as an integral part of their life policy to which it's attached, that would be a major change. And that's going to be not only a system change, obviously, but you may have some customers who may be caught in a difficult tax situation.

I'd like to close with a couple of quick summaries on some items. The valuation interest rate is going down in 1993, as you probably all know. The maximum rate now is 5.5%, it's going down to 5%. The implication on term insurance is substantial in connection with deficiency reserves. Our new term repricing has reflected that, but those companies that have products with deficiency reserves at 5.5% will be looking at what that's going to do to the profitability of that product next year.

I've already heard that some of New York Life's competition will be raising rates in 1993. I think that's due to the deficiency reserve issue. The latest update I got on Regulation Triple X was that the NAIC has not yet adopted a proposal. At the June meeting, there was discussion of it, but no final vote. And it may come up again at the December NAIC meeting. I think the way the timing of this works, it won't go into effect in 1993 even if it is adopted in December. I understand that the regulation, as it currently stands, is favorable in terms of the mortality assumption that can be used in calculating deficiency reserves. And companies, in fact, may be able to use their own experience mortality in calculating those reserves. I think there's an issue for small companies, because there's a certain level of credibility required for that mortality experience in order for it to be used. And small companies have some concern whether they had that level of experience to meet that credibility requirement. It may put them at a disadvantage, if in fact it does go through like that. So obviously there's much more to come on that.

Regarding reinsurance, I think an important issue is that there still is a reinsurance market. Certainly, the reinsurance market and the reinsurance industry drove select-and-ultimate term in the early 1980s, and may have been hurt somewhat by the persistency over the years since then. But nevertheless, there are still quite a few reinsurance companies that are looking for term business. We've been able to work out some very favorable reinsurance treaties for our new products. But an important point to remember is, once you have that treaty in place, don't forget about it. There's more to it than just paying your reinsurance premiums quarterly or monthly. You need to track the reinsurance experience over time, and make sure that reinsurance treaty is favorable, or in fact, not too unfavorable. In other words, if experience is turning out quite a bit better than what was assumed in establishing the reinsurance treaty, you may want to renegotiate that treaty.

Regarding NAIC regulations, there's a proposal that I understand won't have much of an effect on term insurance. It has to do with the deductibility of reserves and the transfer of risk under the reinsurance treaty. There has to be a substantial or significant transfer of risk for the reinsurance reserves to be deductible on the statement. From what I've been told, that really shouldn't have much of an effect on term insurance. It's going to have more of an effect, perhaps, on coinsurance or other types of reinsurance, but YRT reinsurance may not have a problem there.

One last item relates to illustrations, and kind of ties back in with reentry term. Many of us working with participating products have had to deal recently with policies that are unvanishing, and policyowners who didn't understand the issues when they first bought their policies. I think there's a potential problem brewing with reentry term products and policyowners who didn't understand what happens on reentry. There's probably quite a bit of time until that happens, because reentry term is not that old. There aren't that many policyowners who have hit the reentry point yet. I think it's going to be critical to make sure that policyowners understand it. In your illustrations, make sure you are showing the reentry scenario and the nonreentry scenario so that the policyowners understand what the long-term premium risks might be.

MS. POTASKY: Mitch Katcher is a consultant with the New York office of Tillinghast, a Towers Perrin company. In this capacity, he provides consulting services to insurance companies and other financial institutions specializing in nontraditional and separate account market strategies and product development. Prior to joining Tillinghast, Mitch was senior vice president and chief actuary of Monarch Financial Services, the variable products and fixed-annuity affiliate of Monarch Life Insurance Company. Mitch is going to give us a variable product update.

MR. MITCHELL R. KATCHER: I will speak on the variable life insurance marketplace, and provide you with an update. I will use the term variable life insurance generically to include all forms, variable universal life and fixed-premium as well.

Let's start off by taking a statistical look at the marketplace, where it's been, and where it is now. Sales have shifted since 1986 (Table 6).

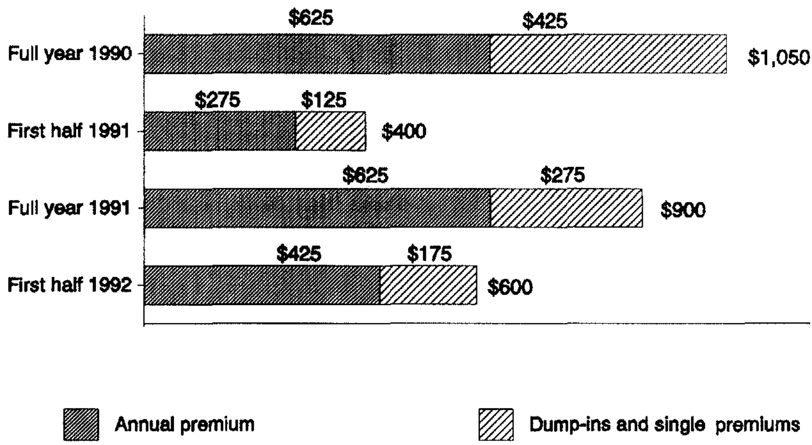
TABLE 6
Sales Shift Since 1986
(in Millions)

Year	Annual Premiums (including dump-ins)	Single Premiums	Total Premiums
1986	$ 650	$1,425	$2,075
1987	1,225	2,600	3,825
1988	1,225	525	1,750
1989	750	100	850
1990	950	100	1,050
1991	885	15	900

Please note that we've included dump-ins with annual premiums to really break the markets down between single-premium, annual-premium, or flexible-premium products. As you can see from Table 6, in 1986-87, single-premium variable life insurance dominated the marketplace. The country was in a roaring bull market, and single-premium policies enjoyed tax-free policy loans. The stock market crashed in October 1987. In 1988, there was talk of taxing distributions from single-premium products. Ultimately, the Technical and Miscellaneous Revenue Act (TAMRA) of 1988 was enacted. This all but dried up the single-premium marketplace. Although sales dropped during 1991, they have surged 50% during the first half of 1992.

Please note, for Chart 4, we've lumped dump-ins with single premiums to show you how the core annual premium, planned premium, whatever you call it, continues to grow.

CHART 4
Variable Universal Life Sales
Annual vs. Dump-ins and Single Premiums



The variable life insurance (VLI) marketplace is dominated by a few companies that distribute primarily through career sales force run-in. As you can see from Chart 5, which is as of the end of 1991, the Prudential and the Equitable accounted for over 60% of all new variable life insurance sales, and the top nine companies accounted for more than 75% of all such sales.

In Table 7, let's take a look at how VLI compares with the individual life insurance marketplace. You can see VLIs share of the market has steadily declined since 1987 from a high, in 1987, of 10% to a low, in 1991, of 6%.

Over that same period of time, term and UL have remained fairly stable while whole life steadily increased. Now, for the purpose of Chart 6, we've excluded dump-ins and only included 10% of single premiums. Although VLIs market share dropped during 1991, it's showing a healthy jump during 1992.

CHART 5
Small Number of Companies Dominate Market

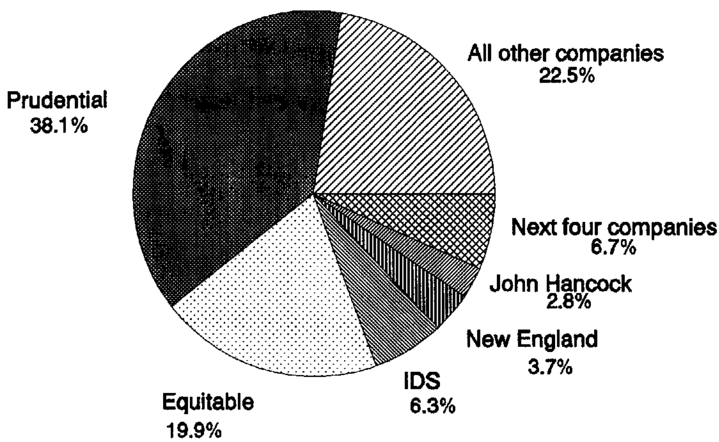


TABLE 7
Market Share Declined Between 1987 and 1991

Year	Whole Life	Term	Universal Life	Variable Life
1986	47%	12%	35%	6%
1987	51	12	27	10
1988	53	13	26	8
1989	53	13	27	7
1990	54	13	26	7
1991	55	13	26	6

This increase has been at the expense of universal life and whole life insurance, reflecting consumers' and agents' dissatisfaction with lower interest rates and reduced dividend scales. Although sales are up for 1992, filings of new products with the SEC are down from 26 in 1989 to eight through October 1992 (Chart 7).

However, the surge in variable life sales during 1992 may well lead to an increase in new product filings during 1993, as there are new entrants in the marketplace filing products, and current entrants in the marketplace enhancing products that have not been updated for quite some time.

CHART 6
Market Share During 1991 and 1992

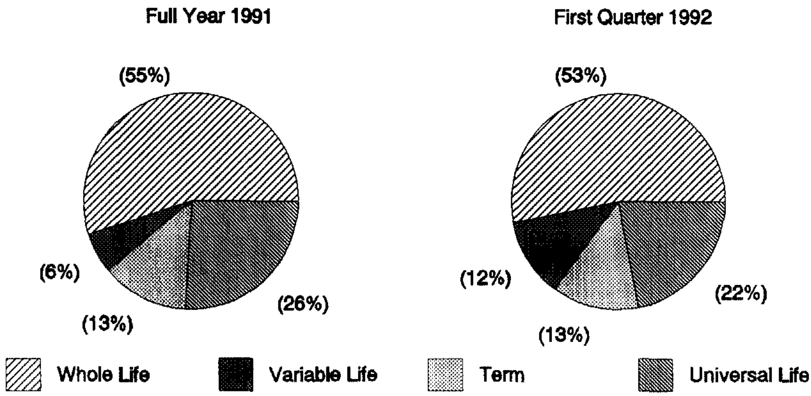
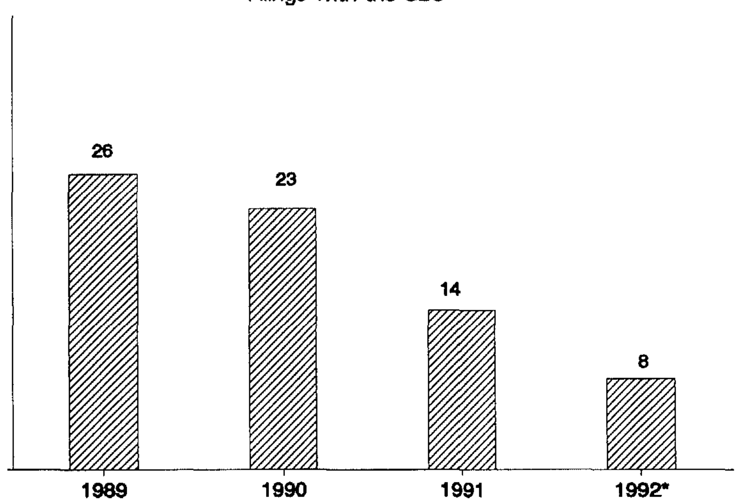


CHART 7
Filings with the SEC



*Through early October

Now let's turn our attention to some recent product and investment trends in the variable life marketplace. First I will discuss some of the new product trends. We're starting to see some structural changes in VLI products. In response to market demands, few companies are emphasizing a guaranteed minimum death benefit. In response to poor premium persistency, other companies are looking at a scheduled premium approach. Greater emphasis is being placed on longer-term values as companies focus on earlier profitability and rewarding persistency. Some products are reducing the mortality and expense charge at the end of 10 or 15 years, while other companies are using a reverse select-and-ultimate cost-of-insurance scale, and other companies are moving to longer surrender charge periods.

In terms of the loading structure, we're seeing a mixed bag. While some companies are looking at a pure back-end surrender charge, other companies are experimenting with greater use of the front-end load. We also are aware of a few companies that intend to have an explicit deferred acquisition cost (DAC) tax load, although there may be some SEC issues that center on whether it's considered sales load or not. Policy liquidity is being enhanced, as we start to see wash loans in the VLI marketplace. Some companies are moving to a preferred risk class. Finally, as a result of profitability and expense coverage concerns, we're seeing some new products with increased minimum face amount sizes.

Chart 8 shows how VLI policyholders have allocated their assets as of June 30, 1992. As you can see from the chart, over 40% of all policyholder assets are invested in domestic stock funds. The fixed account remains popular with just under 20% of such assets.

The other category, which accounts for 1.8%, basically consists of international funds, and a few natural resource and real estate funds. As I just mentioned, fixed account options account for just under 20% of all VLI assets. Although the rates have slipped, they're still competitive as compared to CDs and money market yields. (Chart 9).

As you can see, not only has the range shrunk during the second quarter, but the average credited rate has dropped as well, from 7.47% to 7.32%. Interestingly, these rates are somewhat consistent with universal life, but about 130 basis points greater than variable annuities, which tend to be compared, and more in line with single-premium deferred annuities (SPDAs).

Companies continue to be responsive in the marketplace in designing investment choices. A broader selection of investment choices is being demanded, although policyholders still tend to stick to just a select few options. Buyers are becoming more informed, and thus more focused, on name recognition and track record. Insurance companies are teaming up with mutual fund organizations, such as Fidelity, to meet this demand. In addition, companies continue to be innovative in designing new investment options. An example of this is an updated version of Aetna's Guarantee Equity Trust, or GET account. This option allows a policyholder to participate in most of the appreciation of the stock market while guaranteeing principal at the end of five years.

CHART 8
Allocation of VLI Policyholder Assets
(as of June 30, 1992)

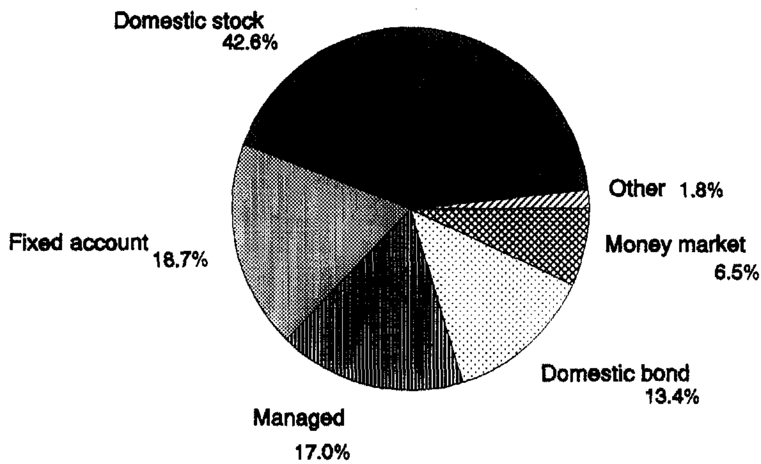
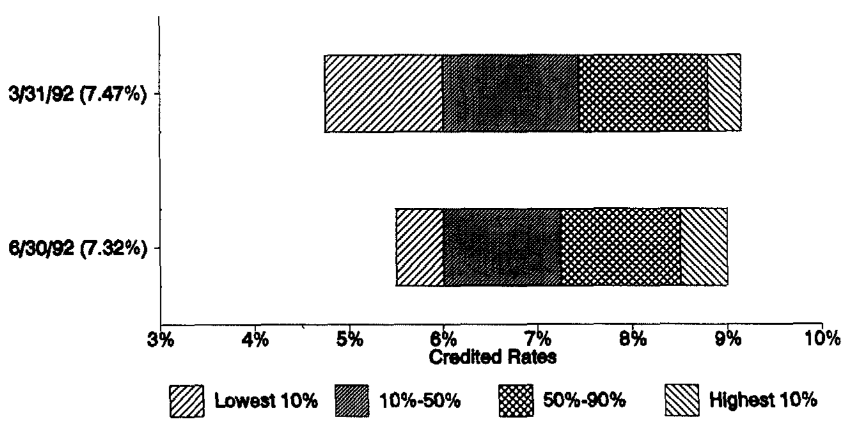


CHART 9
Credited Rates on Fixed Account Options



Now let's turn our attention to the future of SEC regulation of variable-life products. As a backdrop to SEC regulation, since variable products pass certain investment risks on to the contract owners, the contracts are considered securities under the Securities Act of 1933, and the separate accounts are considered investment companies under the Investment Company Act of 1940. On May 21, 1992, the SEC released its long-awaited reported on the Investment Company Act of 1940. This report contained many recommendations for statutory and regulatory changes. Some of these recommendations will, if adopted, impact the regulation of variable-life products.

Overall, our analysis is that, if adopted, these changes will create some opportunities for innovation. Although a full exemption from the 1940 Act is not recommended, what appears to be a more flexible approach to charge regulation is proposed. In addition, the report presents a number of other recommendations that apply to mutual funds in general which, if extended to variable products, could present the industry with additional opportunities for creativity and innovation. The areas I will discuss will be VLIs, separate accounts, advertising, and private placements for nonregistered separate account products.

The report indicated that the recommendations were meant to achieve three basic objectives: maintaining and enhancing the current level of investor protection, facilitating competition through the removal of hurdles, and facilitating innovation. Let's start by taking a look at how VLI charges are currently regulated under the 1940 Act. Sales load deductions are limited to 9% of the premiums paid, or expected to be paid, over the lesser of 20 years or life expectancy. Additional higher loads can be charged in certain years, but the 1940 Act places considerable limits on the amount of any excess load. Administrative expense charges are limited to the cost of services under a flexible premium variable life insurance contract. Under a scheduled-premium contract, administrative expense charges are not limited to cost, but rather to the services provided and the expenses expected to be incurred. Now, the 1940 Act does not specifically govern mortality and expense risk charges. In fact, it doesn't make provision for the deduction of such a charge. Therefore, exemptive relief is required. The SECs current position is that it will not grant exemptive relief for products with mortality and expense risk charges in excess of 60 basis point and 90 basis points for scheduled-premium and flexible-premium products, respectively.

What changes are being proposed? Well, the intent is to give variable life contracts the same flexibility as mutual funds in setting charges, as long as the charges are clearly disclosed and not excessive. The report proposes to eliminate the current charge limits, and replace them with a requirement that aggregate charges be reasonable in relation to the risks assumed by the company, the services provided under the contracts, and the expenses expected to be incurred. In addition, the report proposes to eliminate the refund right, the conversion privilege, and the free-look privilege, although generally, state laws require these provisions as well. And finally, the report proposes to eliminate the stair-step provision.

What does this all mean for variable contracts? As a result of the elimination of the current charge limits and the refund right, variable products should be able to be priced much more in line with their fixed-dollar counterparts. Basically, state nonforfeiture laws will govern minimum values. As a result of the elimination of the de facto limit on mortality and expense risk charges, a company should be able to price an interest spread, in the case of a variable-life product, that would cover mortality and expense risk charge at the same level as its universal life products. The timing for this introduction is some time this year. Legislation is required for full implementation, and it is our understanding that such legislation is being prepared to be part of a larger legislative package that will go to Congress by the end of the year. At that point, it's anyone's guess.

The limited redemption investment company is a new form of investment company also being proposed. This proposal would allow an investment company issuing redeemable securities and investing in less liquid assets, to operate within the open-end framework with more limited redemption requirements than those traditionally applicable to mutual funds. Currently, the SEC requires that redemption proceeds be paid within seven days of the request. In order to comply with this, open-end investment companies must maintain a relatively high level of liquidity. The SEC's current position is that no more than 15% of an open-end investment company's assets can be in nonliquid investments. The interval company, one of the two forms of limited redemption investment companies proposed in the report, if extended to variable products, would create some opportunities for innovative investment options. In an interval company, shares could be redeemed at set intervals, monthly or quarterly, and the fund could require that shareholders give advance notice prior to redeeming. It is our understanding that this proposal is likely to be adopted some time in 1993.

Mutual funds and other investment companies, including variable products separate accounts, are subject to the advertising restrictions in the Securities Act of 1933. Rule 134, the Tombstone Rule, allows almost any type of information to be advertised with the big exception of investment performance. In contrast, those advertisements relying on the safe harbor of Rule 482 can contain information, including investment performance, but it must be in substance in the prospectus. The report recommends changes to the rules which, in essence, will allow companies to advertise information, including investment performance, that's not contained in the prospectus. This will allow companies to slim down their prospectuses, and be a little more creative in how they advertise. It's our understanding that it is the intent to have a formal proposal in place by the end of this year.

For the corporate and upscale, sophisticated markets, private placements and nonregistered VLI products are gaining popularity. Such products do not need to be registered or approved by the SEC. In addition, they are not subject to the charge limits of the 1940 Act. This creates some time and expense savings, and also creates some areas for product development and innovation. The securities issues underlying private placement center around the nonregistration of a variable product. Section 42 of the Securities Act of 1933 provides a statutory exemption from the registration requirements of the 1933 Act, but not, and this is very important, from the antifraud provisions. This statutory exemption has been the subject of numerous court decisions, but the outer bounds are still unclear.

As a result of this uncertainty, the SEC adopted a safe harbor, which it calls Regulation D. Almost all companies currently issuing nonregistered separate account variable products must try to comply with Regulation D. Regulation D is very specific in that it contains a number of rules, any of which you can rely on. The rules vary by the size of the offering, and as you could imagine, the requirements get more onerous as the size of the offering increases. The basic idea is that an offering can be made to an unlimited number of accredited investors, and up to 35 nonaccredited investors. Regulation D defines an accredited investor as a person with a net worth at the time of purchase, or joint net worth, along with that person's spouse, in excess of a million dollars; or, an individual whose income in each of the two preceding years exceeded 200,000, or whose joint income, along with that person's spouse, exceeded 300,000; or, for a corporation or a trust, having assets in excess of $5 million and were not formed for the sole purpose of acquiring the securities in the offering. This safe harbor places limitations on the manner of the offering. Neither the issuer, nor anyone acting on behalf of the issuer, can be engaged in the general solicitation or general advertising.

Integration is also a very important concept. Regulation D outlines a series of factors to be considered in determining whether separate sales of securities are part of the same offering for purposes of the exemption. The basic premise is that offerings need to be distinguished in some fashion. Just as a separate account product needs to look at the Securities Act of 1933 and conform with Regulation D to avoid registration, the separate account funding such contracts needs to look at the 1940 Act and conform with Section 3C1 to be considered a private investment company. Under Section 3C1, an investment company or a separate account cannot be engaged in a public offering under the 1933 Act, and cannot have more than 100 beneficial owners or investors.

The report recommends a new category of investor, which it labels "the qualified purchaser." It is recommended that an offering whose securities are only to qualified purchasers not be subject to the 100-beneficial-owner limit. The extension of this concept to variable products would appear to create new opportunities for nonregistered separate account products in the corporate, upscale, and sophisticated marketplace. It is our understanding that this particular recommendation has a fairly high priority, and could be in place some time next year.

In closing, will VLI be the product of the 1990s, or the relic of the 1980s? Are the best years of VLI behind it, or yet to come? It appears as if the future may be bright for VLI. Let me end by summarizing some of the reasons why companies may get into this marketplace. There is less risk to the company. There is no C-1 or asset default risk. There is no C-3, nor interest rate/disintermediation risk. VLI has much lower risk-based capital requirements than does its fixed-dollar counterparts. The proposed changes to the Investment Company Act of 1940 should allow products to be much more profitably priced. VLI products, if the recommendations are adopted, should be able to be priced much more in line with their fixed-dollar counterparts. Greater consumer awareness and acceptance of VLI products would be an important factor, as well. This may come about as the result of the popularity of the mutual funds and variable annuities. Low credited rates and reduced dividend scales may also foster such an acceptance and awareness. And, as more companies get into the marketplace, consumers will be that much more exposed to VLI products. Greater agent acceptance will also be a critical factor. Competitive or fair compensation, greater consumer awareness, management support, (not just lip service), training, and marketing support are all important factors. And last, and certainly a reason, companies might look to this marketplace for defensive purposes.

FROM THE FLOOR: New York state has this strong position that you can only have one version of a product; you can't have several whole life products, or several term products, unless you differentiate by band. Is that what's happening in your case?

MR. FEINBERG: The New York rule, I think, is a discrimination rule. You can't have different premium rates for people in the same underwriting class, or with the same life expectancy, unless there is some structural difference in the policy. And I'm not aware of any case where that rule has been applied to five- versus ten- or fifteen-year level-term premiums. I think there is enough of a distinction there, from what I'm aware of, that they haven't raised that as an issue.

FROM THE FLOOR: But there would be in a YRT situation, when you have two YRT plans -- one attained age and one select-and-ultimate.

MR. FEINBERG: That's right, that's a good point. That could be raised in that area.

FROM THE FLOOR: Are you really writing family members on those riders? Is that a real situation or is it something you've made available?

MR. FEINBERG: Yes, the last I heard, I believe about 40% of the policies have riders. Now, that may include a rider on the primary insured, but I don't have the break-out. But I can say, definitely, that we are covering children and spouses with that rider.

FROM THE FLOOR: And is it popular with the agents?

MR. FEINBERG: Well, that's the only way we sell them, so I guess that it's reasonably popular. You can get yourself into a situation where the agent is selling more term than permanent, which is a situation agents don't want to be in. But since we encourage conversions, and we put little riders and incentives on the policies to encourage conversions, agents like to have what they call a term bank. So even if they sell term insurance, they feel that they will have good performance in conversions. So, up to now, it hasn't been a problem in terms of the number of different term products that we have.

MR. SCOTT V. CARNEY: You said, on the 10-year product, once they reach year 11, they have two choices. Many of these products actually have a third choice, which gives them the right to convert. What is your thinking about the unhealthy people converting into your permanent block at that point?

MR. FEINBERG: We do have a conversion right. We have two tracks in terms of continuing term insurance, either the increasing premium, if underwriting is not shown and reentry doesn't occur, or reentry. But there is a third option, which is the conversion right, which does exist at that point. And we've priced it for an assumed higher level of conversion at that point, and some extra mortality associated with that.

MS. QUERFELD: I'd like to make a comment, also. LIMRA did a study a couple of years ago which showed about 50% of the policies had a conversion option, but only about 8% of the policies were actually converting, and I think it was about 10% in Canada.

MS. ANNE M. KATCHER: It kind of goes well with this discussion because they have to deal with conversions. I don't know if you know the answer for the study that you were talking about, the Tillinghast study, but both for your company and for Tillinghast, could you share with us what kind of experience is being evidenced on conversions in terms of conversion rates? And also, how long is the conversion period available both by age and duration on these policies?

MR. FEINBERG: The Tillinghast study doesn't give any information on conversion experience. I can give you two sets of conversion rates for New York Life term products. One is what the agents say they convert, and the other is what experience shows. We had a relatively small sample in this survey, but the agents responded to the question, "How much of your term block do you convert?" Now, this was over the lifetime of that term block. Some 40% said it's less than 15% of their business; 30% said 20-30%; 20% said they convert about 33.5% of their business; only 10% say they convert 75% or more. Of our total term in force, in any particular year, we convert about 5% of our business. The conversion right on our increasing-premium term plan runs through age 70. On our 7-year term plan, it runs through age 75. And on our 10-year term plan, it runs through, I think, the greater of 5 years, or age 75.

MS. KATCHER: On the other two policies, is there no durational limitation?

MR. FEINBERG: Right, it's an age limitation. The 10-year term has a durational limitation because we sell it up through age 75, so we want to have at least five years of a conversion right.

MS. KATCHER: I think, on those surveys of agents, if they have the person cancel the term policy and buy a new whole life, that's converting also. That's why it differs so much. They call that a conversion.

MR. FEINBERG: I don't think that would really happen, because they have to show underwriting to do it that way. And, whatever credit we have, the policyowner isn't eligible for. But we have two types of conversions, also. We have original-age conversions on our product, which goes back to the start of the term plan, to pick up a whole-life plan, and we have attained-age. So those conversion rates that I gave you were all the conversions combined.

MR. EDWIN H. BETZ: I wanted to put Mel on the spot on the dividend-option term. Right now, you primarily support term insurance through dividends. What happens in the event of a dividend scale cut from the policyholder's perspective, when he is no longer able to maintain his level death benefit?

MR. FEINBERG: We have two permanent plans on which this option is available. We have the survivorship plan, which has what I call dividend-option term, and we have the regular single-life permanent plans, on which it's available. And the rules currently are different for each one. On the single life plan, if the dividends are not sufficient to support the level of term insurance, then the policyowner has the option to pay out-of-pocket. On the survivorship plan, it's different, and don't ask me why it's different, but if the dividends are not sufficient, the term benefit just comes down. But if dividends are increased, for whatever reason in the future there are enough dividends to support the full amount of term insurance originally applied for, that term insurance total will go back up. If the policyowner in the single-life case doesn't make up the difference, the term insurance does come down. But the single-life case does have the option for the policyowner to pay out-of-pocket.

MR. BETZ: Do you surrender any other dividend credits, dividend additions, to support the term benefit?

MR. FEINBERG: The dump-in rider paid-up additions are surrendered first, and then the paid-up additions purchased by dividends are surrendered next.

MR. ALLEN M. KLEIN: This is probably for Erica. What kind of premium savings do you see on first-to-die versus two single-life policies? And, are those two single-life policies two ULs or one UL and one term?

MS. QUERFELD: There's definitely a big difference between the two, and the second-to-die is the same way. I don't know, offhand, what the savings is, but I think it's substantial.

MR. KLEIN: Are we talking 10% or 30%? Do you have any idea?

MR. FEINBERG: For our survivorship product, the second-to-die product, the premiums are about 60% of two whole lives for insureds of the same ages.

MR. KLEIN: Are you aware of any states that don't allow the one-year grace period for the change in the nonforfeiture interest rate? In other words, are we out of compliance as of January 1, 1993 in any state?

MR. FEINBERG: I'm not aware of any state that doesn't allow that.

MR. MICHAEL L. BARSKY: My question is for Mitch Katcher. To elaborate on this report on the Investment Company Act of 1940, I realize that you're an actuary and not a lawyer, but could you elaborate on what will be required for these changes to be adopted and how likely you think it will be adopted in the next year?

MR. KATCHER: With respect to the charge regulation, full implementation will require legislation. Such legislation will be part of, as I said, a larger omnibus bill that'll go to Congress by the end of the year. I think nobody has any sense of what'll happen, because there could be a new administration, and there could be a new head of the SEC, for that matter. The private placement recommendation has a fairly high priority, and there's a good likelihood that could be adopted some time next year. And I think the same can be said about the limited redemption investment company, or the interval company. In terms of the advertising, a formal proposal will be put in place by the end of the year, at least that's our understanding. But I don't think it's high on the priority list, so I don't have any sense of when it might be adopted.

MR. BARSKY: Have you seen any activity as of late on creating variable survivorship life products?

MR. KATCHER: We've seen some activity. I guess everybody saw in the *National Underwriter* that Equitable has a product that it has been filing. And we've had discussions with a number of companies. I don't think anybody thinks that variable life will replace traditional life in that marketplace. I think a fair number of companies right now think that there might be a niche, because it tends to be an older, more sophisticated market of people who might be comfortable with mutual fund type of investments, and could appreciate the long-term growth potentials.

MR. JEFFREY M. ROBINSON: Erica, do you have any statistics on the second-to-die? Are there many situations where they're selling to the same sex versus both sexes? You know, some of the states are causing problems, or at least, the products I've seen have had problems in pricing for both sexes. And I wonder if there's any appeal for that type of product.

MS. QUERFELD: I don't know if there's any statistics, when they're selling it to dual-income. I don't know of any statistics.

MS. POTASKY: I can report on the New York Life experience on our second-to-die. We do offer it for both sexes, and we've had very, very few sales.

MR. ROBINSON: In New Jersey, you have to provide it, otherwise it's discrimination.