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VARIABLE PRODUCTS -- THE PRODUCT FOR THE 1990s?

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- The market and growth potential
- Distribution trends
- Variable life product trends
- Variable annuity product trends

MR. JOHN G. VRYSEN: I'm the chief actuary at North American Security Life in Boston. We have three panelists who will talk about various aspects of variable products. The first speaker is John Fenton from Tillinghast. He's going to give an overall market outlook discussing a number of different aspects. Bob Bethoney from PaineWebber will be next to talk about the distribution side of variable products. Finally, Randy Thompson, with the law firm of Jones & Blouch in Washington, will speak on some SEC issues.

John Fenton is with Tillinghast in the New York office. He's been with Tillinghast since 1985 and specializes in variable insurance products, mergers, and acquisitions. He's also involved with distribution channel management and certain matters related with the New York insurance law. Before joining Tillinghast, John worked at Metropolitan Life. He has a Bachelor of Science degree from George Washington University. He's also a Fellow of the Society and a Member of the American Academy.

MR. JOHN M. FENTON: My topic is the outlook for variable products, and we're going to talk about variable life and annuity products. I'd like to first discuss an overview of the market, including some recent sales figures. What are some of the new product trends that we see emerging in variable life and annuity products? We've noticed a few expanded markets for variable products, particularly variable life. I'll talk briefly about some investment management issues. Next, because this is an actuarial meeting, we'll throw in a few actuarial issues, and finally, what does the future hold for variable life and variable annuities?

First, let's discuss an overview of the market. I think many of you know variable product sales have continued to grow rapidly. In 1992 the variable annuity marketplace reached a total of \$24.5 billion of sales, and the variable life was a total of \$1.3 billion. The source for this is the Tillinghast Value Survey that we conduct (Table 1).

* Mr. Bethoney, not a member of the sponsoring organizations, is the Senior Vice President/Product Director with PaineWebber Inc. in Weehawken, New Jersey.

† Mr. Thompson, not a member of the sponsoring organizations, is a Partner at the law firm of Jones & Blouch in Washington, District of Columbia.

TABLE 1
Variable Product Sales Continue to Grow Rapidly
First-Year Premiums (Billions)

Year	Annuities Total	Life		
		Annual	Single	Total
1987	\$3.6	\$1.2	\$2.6	\$3.8
1988	6.5	1.2	0.5	1.7
1989	8.5	0.8	0.1	0.9
1990	12.5	1.0	0.1	1.1
1991	16.0	0.9	0.0	0.9
1992	24.5	1.3	0.0	1.3

Source: Tillinghast VALUE Survey

Both variable life and annuity were up over 50% in 1992 versus 1991, and we do have some early figures now for the first quarter of 1993. Not all the results are in for all the companies, but we do have substantial amounts, and note that variable annuity is up 30% over the first quarter of 1992. I'd like to make an observation: That was against a relatively high base because of the proposed tax law changes then. For the companies that we have reported, variable life sales are up 70% over the first quarter of 1992. That's probably going to come down and be closer to 50% when the other companies in the survey come in, but that is a significant increase, obviously, and we see that the variable product resurgence is continuing.

In terms of market share, variable annuities were probably about 40% in 1992, and that's moving up towards 50% in 1993. I think the first six months of market share for variable life for 1992 were at about 12%, and that's probably going to read 16-17% by the end of 1993, so there are some significant numbers there.

Who are the big sellers in variable annuities? Table 2 shows the top six carriers in terms of total first-year premium. Lincoln National leads the pack at \$2.7 billion, followed by Hartford, IDS, Nationwide, Equitable, and Prudential. I have just a few observations on these companies other than, obviously, they're very good marketers of variable annuities. All are selling a significant amount of qualified business ranging from 40% to as high as 75%, and by that I mean IRA rollovers, 401(k) business, 403(b), and 457, excluding the group pension figures. They're using a variety of distribution channels in there. We see companies selling through stockbrokers, agent forces, financial planners, and banks as well, so it's across the board.

Here's the big picture in terms of where our sales are coming from variable annuities. Chart 1 shows the distribution of sales for the first six months in 1992 by distribution channel, and we see that stockbrokers are leading the pack at 37%, followed by the agency forces at 35%, financial planners at 18%, banks at 6%, and direct response at 4%. Since then I'd say the banks have probably picked up their share moving from 6% closer to 10%. I don't have any specific figures, but we have seen growth there. I'd say that probably the most surprising result I would see here is that the agency forces are a major player in this market. Initially when I thought of variable

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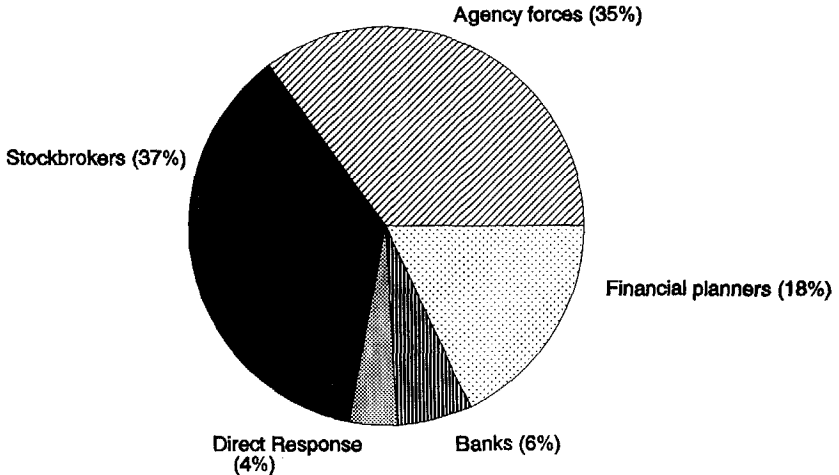
annuities, I thought of the stockbroker selling nonqualified products, but here we see that the agency forces are a big player in the qualified market. There's no similar survey for variable life, but my guess is that the agency forces, career and personal producing general agent (PPGA), account for probably over 85% of the total sales, financial planners somewhere around 10%, and the rest of the channel showing up there somewhat under 5%.

TABLE 2
Leading Variable Annuity Sellers in 1992
First-Year Premium (Billions)

Lincoln National	\$2.7
Hartford	2.2
IDS	2.0
Nationwide	1.8
Equitable	1.7
Prudential	1.4
Other companies	12.7
Total	\$24.5

Source: Tillinghast VALUE Survey

CHART 1
Distribution of Variable Annuities by Channel



Source: Tillinghast survey (first six months of 1992)

Why is the variable annuity product so popular? I think there are several reasons for this. I think the number one reason is basically that the average new money crediting

rate on single premium deferred annuity (SPDA) contracts right now is about 5.50%. It's not so much that the market has performed so outstandingly in recent times. The year 1991 was a very good one. The year 1992 was somewhat mixed, but essentially we're in a low interest rate environment, and it's really not hard to sell a variable product in that marketplace. That's coupled with mutual fund sales, which did increase significantly in 1992. I think we're hitting record sales each month. In the nonqualified market the variable annuity essentially is sold as a tax deferred mutual fund with guarantees, and it provides a better after-tax return than the mutual funds, so I think those are some of the reasons that we see for the variable annuity success. It's also becoming more popular in the bank market. I would expect this to grow rapidly with CD rates at about 3%, and there is much potential here for expansion of sales. The qualified market is also growing rapidly. Corporations are still adding 401(k) plans, and more individuals are using these plans. We also see growth in the IRA rollover business as more people switch jobs either of their volition or otherwise.

Another area of activity that we see is a fair amount of joint venture activity particularly in variable annuities. There are many new players looking to enter the marketplace. The small- and mid-sized insurance companies don't want to miss out on the boom. They probably can't afford to do the funds themselves, so they're looking for external fund management and perhaps some distribution as well. The banks and particularly the smaller mutual funds also want to enter. The large mutual funds really have been in the market for a while, but the smaller mutual funds and the banks want to get in. They are bringing fund management to the table and also some distribution in many cases. I'd say the variable annuity business is more of a commodity marketplace where the key issues are really which funds to offer and how do you distribute the products.

In regard to variable life, who are the big sellers? (See Table 3.) Prudential and Equitable continue to lead the pack, and agency forces and particularly the career agencies are still the dominant players here. However, we do see some of the PPGA and brokerage companies like Pacific Mutual and Western Reserve coming on fairly strong entering the top seven or eight. I think on variable life it is important to note that for some companies like Equitable and Provident Mutual variable life is a major part of their portfolio. It accounts for over 50% of their individual life production. The reasons for the variable life success I'd say are similar to variable annuities to some extent. Obviously, the low interest rates on universal life (UL), about 7%, is somewhat higher than the SPDAs because of the portfolio rates. Still variable UL (VUL) was quite attractive relative to that rate. I think another big thing is that there's been a strong push from senior management. Many of the top sellers have senior managements who decided that variable life is really going to be the product that they lead with. The new agents must be registered. UL credited rates are kept somewhat down, suppressed. Companies like the low risk-based-capital (RBC) requirements and to be able to get off the investment risk that is on traditional UL-type products. We see greater consumer comfort overall with mutual fund investing that translates into variable insurance products. Also, I think licensing is becoming less of an obstacle. We're seeing more sales, as I mentioned, from the PPGA and brokerage distribution companies, and I would expect that to continue in the future.

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Okay, let's turn to some new product trends. What are some of the things that we're seeing on variable annuities and variable life? Let's talk about annuities first. As I observed earlier, I'd say the variable annuity product is becoming more of a commodity-type product, therefore, more of the product changes can really be termed as bells and whistles. But most activity is on the fund side.

TABLE 3
Leading Variable Life Sellers in 1992
First-Year Premiums (Millions)

Prudential	\$502
Equitable	242
IDS	96
New England	62
John Hancock	43
Pacific Mutual	40
Other companies	365
Total	\$1,350

Source: Tillinghast VALUE Survey

There is an overall trend in variable annuities toward higher asset charges, particularly in the broker-dealer and wire house community. Several years ago the products were priced with a 125 basis point asset charge often in mortality expense. Now the market has moved to a 140 basis points charge, with mortality expense still capped at the 125, by and large, and an extra 15 for administration. There are also a few companies now that are adding a separate guaranteed minimum death benefit (GMDB) risk charge. There's a potential to go past the 140 in the future. Now the higher asset charges overall allow a company to price the compensation very close to what's found on an SPDA product.

Other new trends that we see are the introduction of an A versus B units concept for the mutual fund community. National Home has this product. The A product is front-end loaded. It's got 5.75% front-end load, no surrender charge, and 80 basis points of asset charges. The B product is the more typical variable annuity. It has no front-end load, 6% initial surrender charge, and a 140 basis point asset charges. Now even though the B is more typical and is more popular, the A will eventually outperform the B because of the lower asset charges it has after a ten- to 15-year period.

I think the market's going to stay with the back-end-loaded product unless we see some change on the state side in terms of reserving requirements. I understand that California for new entrants makes you hold the account value for reserves. If other states move to that, we could see more front-end-load-type designs.

There's also one or two low load products out there. Vanguard has a product. I understand that Fleet is coming out with one. Essentially they have very low or no distribution price, but mortality and expense (M&E) charges are in the 40 to 55 basis point range. There's also one or two limited offering products on the fund side used

to jump-start a fund and get monies in up-front, by making them available for a certain time only.

Trailer commissions are another product trend. I'm just going to talk briefly about this. It's still a problem to New York licensed companies. Essentially, if you're licensed in New York, you're not allowed to pay a trailer commission on an SPDA contract or single premium variable annuity.

What are some of the bells and whistles that we see on variable annuities:

1. Stepped-up GMDB
2. Dollar-cost averaging
3. Systematic withdrawals
4. Nursing home waiver
5. Fixed option with market-value adjustment
6. Automatic asset allocation
7. Interest sweep

Probably the most important one is the stepped up or enhanced GMDB. The original GMDB paid the greater of the account value or the sum of premiums paid. But now virtually all the new products have an enhanced death benefit where either they reset the death benefit periodically to the account value every five to seven years or have the premium portion grow with interest at a rate of 5-7%. It should be noted, by the way, New York has a problem with this latter feature. Some of the very new products have multiple resets and have increased 5% growth up to 7% to be even more aggressive. The cost of these features is not insignificant.

Now turning to variable life there's more room for creativity in a variable life product than a variable annuity because there are more working parts in the life component. The focus that we've seen here is mostly in improving competitive value, both at later durations and, also, at higher face amounts. There's more competition in the markets these days. Newer products are coming out, new entrants are coming into the market, and existing products are being redesigned.

What are some of the recent enhancements that we've seen? The first is probably the reduced interest spread in later years. For example, Pacific Mutual cuts its 75 basis point M&E risk charge down to 25 points in year 11, and Ameritas cuts from 90 to 60 points in year 20. Alternatively, you could have the reduction in interest spread expressed as a reduction in cost of insurance (COI) charges similar to what Equitable does. I think the reason this is popular is that in pricing products, after you meet the break-even year criterion in years 10 to 15, you often have excess margins in the product and you're able to reduce charges and improve later year value. Now with this particular feature there are some administrative issues to which you need to pay attention. You don't want to have select and ultimate unit values. You need to reflect these values in a different way.

Another trend is the disappearing current front-end load. For example, Prudential's 6% load is down to zero after I think the sixth year. Equitable has a 4% front-end sales load that goes to zero after ten years, and Pacific Mutual cuts its 4% load down to 2% at the same time. We're also seeing loads waived at higher face amounts. John Hancock has a 4.5% front-end sales load that it reduces to zero at \$250,000

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and above. Prudential cuts its M&E risk charge from 90 basis points down to 60 at \$100,000. At least one company also has an explicit deferred acquisition cost (DAC) tax load, ManuLife. ManuLife received individual exemptive relief for a charge of 1.25% of premium. There's some indications though that the SEC felt uncomfortable with giving other similar type of exemptive relief, and I believe that issue is being discussed right now. Low cost loans are another feature that's popular. ManuLife has introduced a no loss loan, and others are at 50-75 basis points. I guess finally there is the survivorship product, and we're going to talk about that later on.

What are some of the expanded markets that we see for variable products? Here we're going to concentrate briefly on variable life. Until recently variable life was sold pretty much in the core marketing applications, essentially for death benefit protection with an investment twist, the college savings market, and retirement savings. But now we're seeing some more life products being tailored to other markets. First is the estate planning market second to die. Equitable has introduced a product. Provident Mutual and Merrill have filed and should come out with one soon. Other companies are working on it. An observation here is, it's harder to get margins out of this product because there are very limited margins available in the COI charges, so you may need to move to a front-end-load-type of design here.

Another market is the upscale market. We're seeing more products priced with minimum face amounts of \$250,000-500,000, and this is a market that's attracting much attention. We're also seeing nonqualified funding applications, corporate owned, mostly small businesses. We're still talking about registered products, but applications for split dollar, deferred compensation, pension/savings. And in this particular market the high early cash value is important. There's also the corporate owned funding vehicle where we're using group VUL on a nonregistered basis to meet needs from FAS 106, which is the retirement medical or large deferred compensation types of applications. This latter market is really kind of hard to gauge how big it is, but I would guess that it's probably in the \$400-600 million of new premium range for 1992, and there is much potential in this particular marketplace.

Moving on into investment management issues, there are just a few things you ought to think about when you're selecting your investment options. I see a trend towards external fund managers in particular on the variable annuity products. Many new products are a result of joint venture activity and use external fund managers and, in many cases, more than one external fund manager. The name recognition of the fund manager used to be of primary importance before track records existed on the variable annuities, but now we're really moved to performance ranking. More funds have reached that five-year track record, and they compete on how well they perform compared to other similar types of funds. So you really need to be attractive to rank high up on how well you did in terms of the managed funds.

Another thing is critical mass. It's very difficult to achieve critical mass on your funds on variable life alone. You need to either tie in with a variable annuity or sell a lot of variable life. What I've heard is that you generally need \$50-200 million per fund to break even, and it's tough to get there and it's generally on three to five funds. It's very tough to get there selling \$10 million of individual life premium a year. There are several things you do need to look at in terms of the break-even size. You need to

factor in renewal premiums, but I think essentially it's very difficult for most companies without annuities, thus leading them to use an external fund manager.

The other thing is that more companies are offering a broader selection of funds. On variable annuities I'd say that two years ago the average number of funds was about four or five. Now we're up to an average of seven funds for each product. I think there are two products out there that have 19 funds, so you're seeing more types of that expansion of fund choices. On your investment options it's very important in your variable annuities to have telephone transfers. They really are a must.

Let's talk about a few actuarial issues. Let's discuss expense issues, comparing variable to nonvariable products. The distribution of variable products is not really inherently more expensive than a fixed product; however, it's still the largest expense item in terms of pricing variable life, and variable annuity as well, so you do need to pay attention to it. Generally you can price the same amount of competition in your variable life as your UL or your variable annuity as your annuity. So that's really not so much of an issue. Maintenance costs, of course, are higher because of the SEC requirements in variable products, and this is mostly driven from the systems requirements, the fact that you really need to have a separate administrative system to drive your product, and that's going to drive your costs up. It really varies in the larger up-front investments, but it's probably 10-30% higher on a unit expense basis.

The other thing that's worth observing is that the fund operations introduce a new cost component in terms of pricing a product, and you need to look at the break-even fund size that we've talked about a little bit. Of course, when you do reach a large fund size, the investment advisory fees, if you keep those internal, can be a significant source of revenue.

The next issue is the GMDB for variable annuities. I think the best way to approach determining the cost of this is the study based on a series of randomly generated interest scenarios. However, I would say that not many companies are using this approach. Probably within the last year more are doing it that way, but still not everyone is there. The cost is not insignificant. It's going to vary depending on the type of feature that you have, but it generally ranges from 3 to 15 basis points. It could be even as high as 20 in some situations. The cost impact depends on the actual type of feature you have. Do you have multiple reset? Do you cap the death benefit? What interest rate do you use in growing premiums? Also consider the issue age. Some companies limit the features at the higher issues ages and that's important. Also, would your block of business have a mix that's different, as an older mix would drive up the cost? Another factor in the cost is your expectations about future interest rates. Even though we're using the stochastic testing, we have to make some assumptions about what the funds are going to return overall, so that's important. The other thing is the degree of investment antiselection. It could be a concern if the policyholder locks into the loss when the market has a correction, so you need to keep that in mind.

In variable life I think we used a similar methodology to study the cost as for variable annuities but the factors are somewhat different. First, we'd look at the length of guarantees at age 65 or what it was for life and the other thing is what is the implicit interest rate guarantee that's in your premium requirement? Generally, companies

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require premiums to be paid, obviously, to get the death benefit. There are premiums priced at a 4% rate or 6% rate that are going to have an impact on the cost. And, of course, we must look at the reserve requirements. You need to look at those as well in terms of determining what your costs are.

Now I wanted to talk for a minute about RBC requirements. The facts are shown here for a 100% level (Table 4). Of course, your company may decide to be at a higher level than this, it's quite probable, but the requirements shown here are for a 100% level. The table shows separate account and general account requirements. The C-2 risk, obviously, is only applicable for life products, and the C-3 component for the general account would differ depending if it's life or annuity reserves, but what's interesting is in variable annuities the only requirement is 2% of premium. If you have a single premium variable annuity, you set that up in the first year and it goes away the next year. So it could be very low RBC. It does add to your surplus stream. But I think by making the comparison here and perhaps increasing these by a factor of one-and-a-half or so, you see that separate account variable business is going to have lower RBC requirements, and it's going to give you competitive advantage in pricing the products.

TABLE 4
Variable Life Products Have Low RBC Requirements

Category	Driver	Separate Account	General Account
C-1	Assets	0.00%	Varies; average of 1.00%
C-2	NAR	0.60-1.50	0.60-1.50
C-3	Reserves	0.00	0.50-0.75
C-4	Premium	2.00	2.00

Now what does the future hold for variable products? I'd say that, first of all, the short-term outlook for variable annuities is very rosy. Fixed rates are at 20-year lows. It's really not hard to compete with an SPDA crediting 5.5% right now. I think also it's rosy because higher marginal tax rates are likely, and that improves the variable annuity relative to mutual funds. Consumers have a continuing love affair with mutual funds. Money is essentially pouring in, and variable annuities are going to attract their significant share. I think also two factors will help in terms of generating more savings dollars: both the economic environment improving, as well as the aging of the population. I guess finally the expansion of the bank customer open new market. There's a tremendous amount of annuity business out there. I think that turning to variable annuities is quite possible.

But we do need to look at a few longer-term issues. If the key question is how the consumer is going to cope with the inevitable market correction, I think for this reason it is important for products that you have to have safeguards, fixed accounts, telephone transfers, things of that sort. I think, obviously, what's going to happen will depend on the size of the correction, and the reaction may very likely vary by the type of market that you have. I also think that the reaction may be more a significant correction in terms of new sales as opposed to losing in-force business. The other major issue, of course, when we talk about variable annuities, is the tax advantages. I don't have a crystal ball. I can't really tell you exactly what's going to happen. I

am concerned that, if annuities are marketed too aggressively, we could be losing the golden goose since the tax advantages would be restricted or eliminated.

Turning to variable life, again, I guess similar to the variable annuities I'd say the success is driven predominately by the low interest rate environment that we're in, and as long as we stay in it, I think variable life is going to be very attractive. I think sales will grow. I could see the market share increase. I talked about 16-17%. When new companies get in, that could easily go up over 20%. I think agent acceptance of the product is important. Often new agents who are coming in the business are licensed and less concerned about selling guarantees. The extent to which senior management supports the product and encourages it is also very important. Of course, one question that's out there is, what's going to happen to the investment-oriented sales if the annuity tax advantages are restricted? It's possible that variable life could help fill the void.

I think another important impetus to the variable life market is an expansion of the corporate market. Retirement medical could be a large funding need, and that depends I think on what happens to the Clinton health care task force, but I think that significant growth could be achieved in that particular market. So in summary what we're really saying is that variable sales are being helped tremendously by the low interest rate environment. I would expect to see continuing growth in market share. If we continue to stay in this environment, I think there's some excellent potential for the product.

MR. VRYSEN: Now one of the things that John mentioned in his discussion on his distribution analysis was that 37% of all variable annuity sales came from stock-brokers. Our next speaker, Bob Bethoney is with PaineWebber and PaineWebber accounts for a significant portion of that 37%. Bob is senior vice president of PaineWebber and, also, the product manager for insurance products. He's been in the insurance business for 26 years, the first 14 years with E. F. Hutton where he effectively built the entire insurance department at E. F. Hutton. In 1982, he set up his own organization with a couple of other individuals called Eden Financial in Boston, and that was primarily an annuity wholesaling firm, so he's involved both on the inside and the outside. Then he came back inside at PaineWebber in 1988. At that time PaineWebber was ranked number seven out of seven companies as far as insurance products as measured by the McLagan Study that measures full service brokerage firms or wire house production. He took the company from number seven in 1988 up to number one in 1991, and I believe it is still number one in variable annuities in 1992. Bob got his bachelor's degree at Columbia and his master's degree at Harvard.

MR. ROBERT J. BETHONEY: We respectfully refer to Hutton at PaineWebber as the H firm. The way to keep a marketing guy honest is to put him between an actuary and an attorney. It's very disconcerting I might add. On the one hand you have to tell the truth. On the other hand you have to be legal about it. I want to talk a little bit about where the annuity has been over the time that I've been involved with it, and I started with the H firm when it began introducing annuities back in 1973 with companies like INA and VALIC. At that time the annuity was a product that, today, would probably do a billion dollars in a month. It was a very consumer-centered product at that time. As time went on things changed, and I kept hearing things like

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annuities are dead. I heard this back when the step-up and basis was lost. I heard it under TEFRA when we lost things like FIFO. You'd have to pay taxes on the first dollar you draw out, because TEFRA converted FIFO withdrawals to LIFO. You knew about the penalties. You knew we can't borrow from an annuity any longer, although I was always suspect of section 264. DEFRA came along and enhanced the penalty tax a bit, forced distribution at death, and limited section 1035 exchanges as to the grandfathering of pre-TEFRA contracts. So it's been an interesting career notwithstanding what happened in the Tax Reform Act of 1986, which essentially closed down a whole market for us, that is the corporate market where you could not have an unnatural person as the owner unless the annuitant had some beneficial interest in the contract. So all these changes kept the hue and cry coming forward that annuities are dead, and I guess that John in his talk proved otherwise, that we certainly are not in a dead environment as far as variable annuities are concerned.

Back in 1988 as John Vrysen mentioned, I was with Eden in semiretirement, and I decided to come out and joined PaineWebber and sold part of my company in 1988, and we did another final purchase in March 1993. It's been an interesting experience because I really felt that there was tremendous potential at PaineWebber in the stockbrokerage industry, if only we came to grips with the fact that the decisions in marketing a product don't come from the top down, but they come from the bottom up. That's always been my credo, and my products and my delivery system have always been client-centered and broker friendly.

What happened to us at PaineWebber was to some extent *serendipitous* because, when you look at the trend that annuities took, we made a very concerted effort, a very deliberate marketing decision in September 1990. When you go to a firm like a PaineWebber, or a Merrill, or a Shearson, or whatever those friends evolve to become, you'd really have to come to grips with the fact that you have to be on the same page with their economists, their market analysts, their investment strategists if you want to survive in that environment. In early 1990, Dr. Morrie Harris, who's our economist, and Ned Kirschner at PaineWebber said we're going to six in 1996 and we're going to see a stock market that is going to be on the brink of 4,000 by the year 1993-94. Now they're talking 5,000 at the turn of 1995 and 7,000 by the end of the decade. It's a feeding frenzy on optimism, but nevertheless, you've got to be brain dead to hear that and not decide that, even though we were in the halcyon days of fixed annuity business, it was time to make a shift and we did in 1991. We were the largest seller of variable annuities of all wire houses, in fact, all houses by Massachusetts Financial Services (MFS) standards, in absolute terms. We were not only number one in McLagan on a per investment executive basis, but also our market share grew from a measly 6-16%, and now it's going to 23% of the industry wire houses that are measured by McLagan. The company, in fact, thought I had been on some sort of an opiate when I made that decision, but I, nevertheless, did. It served us well because I didn't foresee that in 1991 in the spring we would have an event that would somewhat impugn the fixed annuity business probably for a long time to come, and that was the year of conservatorship, which we quickly labeled the period of purge. Brokers like those things, and we took a negative and made it a positive. So 1991 was a period of purge; 1992 was the year of recovery; and again, we were number one in wire houses in absolute sense in variable annuity revenues ahead of Merrill and Shearson, and we expect to maintain that since our first quarter was up 58.1% over the first quarter of 1992.

How did we do all this? Well, we don't do it with bells and whistles or with mirrors. We do it because we're very simple. We're kind of just old country boys, and we depend on the people like yourselves to give us products that the broker thinks he can sell that the market can withstand. And we think that those products have to be for the most part products for all seasons. John touched upon that briefly. He said, if we have a correction in the market, we may be in for some trouble, but you can condition the broker in advance that this is a chameleon, it's a product that changes its colors to match the financial environments that are external. It also satisfies the internal needs of the client in terms of his financial long-term objectives, and it somehow through the GMDB and other fancy death benefits satisfies the need for a speculative desire to be satisfied when he dies.

We have come up with this GMDB in the market today. Why? Because the broker had to grab onto something that said guaranteed. He couldn't see it in a product that passed on the risk to the consumer, but he had to have something real or perceived, a benefit, that he could tag a line to that said guaranteed. So the GMDB came into vogue, and now you almost have to have it to survive the business. I don't believe that, because if you need a GMDB of 7%, you might as well fire all your money managers as far as I'm concerned. So the GMDB is a perceptual value of the product. You can sell around it, we've proved that. You can see some of the products that are number two at PaineWebber, like Hartford's Director and Putnam, don't have that feature. Our number one product happens to have it, the Specialty Manager, which is sold by Variable, yes, because the Variable people lead with that and the broker is hooked onto it when it gets to that issue in selling the product to his clients. So it's a perceptual value. At some point it may become so prohibitively expensive that we will do away with it. For us at PaineWebber and other firms as well, we really focus on the built-in mechanism that supports the underlying performance of a variable annuity. We distribute that product through specialists that are outside of PaineWebber, peripheral resources that have a symbiotic relationship with us. We don't build huge infrastructures. We depend on your companies, your distribution systems, your wholesalers to market our product, your product to our people. We have ten people at PaineWebber, ten who are simply managers of resources. We use those resources because they're contemporary, they're professional, and they're hungry. You can't pay a person enough at a wire house to make them as voraciously hungry as a wholesaler is when he comes inside and looks at the potential that's available to him at PaineWebber. So, number one, we look at the underlying assets, and we lockstep those assets with the funds that are not necessarily best performing industrywide, but best performing within our purview, within the framework of PaineWebber. So if Wellington's very popular, we work with Wellington. If Franklin is popular, we work with Franklin, Putnam, and so on. By the way, we don't have just one product or two products at PaineWebber, we have a plethora of products, and the word has been out there, if you have a new product, bring it to Bethoney. Well, that may be true, but if you take a look geographically at the way PaineWebber's performance has been in all products, it's not the same. It's a spectrum of success. If you look in the northeast division, it may be successful in Putnam. If you look out in the west coast, it's Franklin funds. In the southeast it may be Wellington. So every geographic division, every purview, every territory has successfully marketed a particular fund group.

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Take a look at our money management program at PaineWebber called Access, called other things at other firms. If you look at it and do a CAT scan view of it, you'll find that not every Access manager is successful in every geographic area of Paine-Webber, so how am I to tell which is going to be successful? What I do is look at the situation analysis and let it emerge from the bottom up, so that's why we have a number of programs in PaineWebber, but we fine-tuned it two-and-a-half years ago by simply involving ourselves with a marketing strategy called a franchise strategy. The franchise strategy and distribution of this product simply says that, if I were to direct you to my best office, I would have 400 wholesalers wearing the carpet out in let's say Indian Wells, or Dayton, or Palm Springs, or San Francisco.

You start out at an O branch, but it's PaineWebber's C branch. You focus there. You raise the level of that branch from a C to an A, and you'll be accepted there because your product is successful, albeit, only moderately successful in deference to the success of products elsewhere. What did it do to my C branch? It raised my C branch to a B branch and therein lies the incremental revenues that accrued to PaineWebber in the last several years. We didn't have everybody grouping and polarizing and magnetized to the best successes at PaineWebber, but we've directed them to where their successes emerged and so we had all these little people running around and, by the way, it was in your best interest, too. Because from an economic point of view it was more efficient for these wholesalers to work where they were successful than to try to blanket the whole country. I learned that when Merrill Lynch says you must cover all of our 4,000 branches; I would have had to hire 250 wholesalers. We had 20. So I feel now that that's the best way to make the efficient use of the people distributing your products.

How do we help you create the critical mass in the products? We created a program called The Syndicate Offering. Two-and-a-half years in the making our first offering was with Felix Zoolof, BARRON's roundtable. We went out for a period of a month-and-a-half or six weeks and raised \$46 million in that one product area. We followed it with Roger Engemann in The Syndicate Offering with the WoodLogan people, and so on.

Next we're doing something differently. In June and July 1993 we're taking a major insurance company domiciled in New York with a very visible money manager, I'm being vague by design and on purpose, and not only are we going to manage and market him inside of this rather triple A company, but also we've solicited other firms to join our "Syndicate Offering." We'll pay for all the literature. We'll pay for the road show. We'll bring it to the industry, and we've created a cosmetic Syndicate Offering, again, another way to create critical mass in the product quickly. At PaineWebber, by the way, I might add that our successes are done basically with 56% of our brokers variable licensed.

How about compensation? Where does that lie? Well, it doesn't lie anywhere, frankly, because you have to take a look at the person who's marketing your product. If you look at up-front commissions, you're looking at a broker who markets a product with up-front commissions as a broker-chasing gross. What do I mean by that? Well, he's a young broker, he's unestablished, he doesn't have a large book. He's looking to make his month. He's looking to survive. He looks at this product with a large up-front commission, his dialysis, a way to stay alive in the business.

You take a look at a seasoned broker to whom we're directing our attention in a very elitist fashion because we consider all the others to be muskrats. They don't have the necessary tools and skills to market these kinds of products that you incisively intellectual actuaries create for us, so we go to the elitist group. We go to the group who has the largest access and the largest control over the largest number of assets at PaineWebber. Those are the club members as we call them. People who are presidents, chairmen, and so on, are club members, and we literally go after them by design, by invitation because they have three of the key ingredients to being successful in this business. The acronym for these ingredients is ASK. They have great attitude. They have great selling skills. They have no knowledge and so we train them well. By the way, those brokers are more inclined to sell the levelized commission product or the product that pays 1% a year than they are the up-front commission. For them I've heard it said many times, they'll put a \$100 million of variable annuity and go fishing. So, again, there's no right answer. There's no middle ground either, by the way. There's no modest commission and then trails and try to squeeze it. It doesn't work. It's either all up-front or all levelized. So we don't really like the middle ground. So, again, on the compensation issue there is no right answer. Since the product is marketed at different market segments, the compensation has to be geared to satisfy those segments.

Where do I modestly think the opportunities for growth lie? Well, I think they lie, number one, in the income products. We find more and more that the broker is looking to raise the level of this client's income, whether it be through sophisticatedly designed immediate annuity products that pay you for a reasonable period of time and return your principal, or whether it is done through withdrawals through systematic means in the variable annuity, it really doesn't matter. The client is looking for enhancing his income into retirement. To provide for the period after that man stops working, he has to really create velocity in his money at work.

Lump-sum distributions will be a bit of an esoteric market. We are finding more through another division at PaineWebber that there's a need for people exiting from the plans looking for income or looking for ways to professionally manage their money into retirement, so we have lump-sum distributions. In the old days when I marketed I was a wholesaler for Metropolitan Life. We used to call it terminal funding, but it had such an onerous ring to it we changed it to distribution annuity. That type of product was to provide for long-term care. Now the way we market long-term care is through a product some of you know as a protector. Why? Because we don't like rentable long-term-care products. We like to at least have some value, whether it's a death benefit or a cash-value buildup in the event that you go into a nursing home. We can't say that about death, but we could say that about nursing home care, so you have some substance to that investment over time. So long-term care is certainly a viable future for you at our firm at least, and I think within our industry for that matter.

Variable life products need a little bit more developing in my mind. I don't want to be the first out of the box. I'd like to let the rest make all the mistakes with it, and then I'll see what we could do about it. I think the variable life product is certainly viable, but I don't like to sell it and make its value on a negative basis, that is the loss of the inside buildup of variable annuity. I think it has its place, but I need to see a better design, and I need to see a seamless transition personally from what is a successful

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variable annuity to what will be a variable life product. It cannot be viewed from my point of view as a new product. It must be directed in a seamless fashion between what has been successful in variable annuities to what will be successful in variable life.

MR. VRYSEN: Now after hearing from a consultant and a salesman we'll get a lawyer up here to pull all the facts together and cover some issues. I asked Randy to speak just to cover what SEC and regulatory-type issues are important to address in this market. Randy's with the law firm of Jones & Blouch. He's a partner there. He's been there since 1988. Jones & Blouch is a small Washington law firm that specializes in security law, especially for the life insurance industry. He's been doing that for 25 years. Prior to joining Jones & Blouch, Randy was at the SEC. He was there for 12 years, and the last four years he was Chief of the Office of Insurance Products, so he's involved from the inside dealing with many of the issues that we're just struggling with today. The Office of Insurance Products is responsible for reviewing insurance companies' SEC filings for variable products, it drafts rules related to offerings of variable products, and it participates in inspections of separate accounts of the variable products. Randy got his graduate degree at Harvard and his law degree at Georgetown University.

MR. W. RANDOLPH THOMPSON: I have to admit to having a little bit of residual nervousness about speaking to an insurance industry group about M&E risk limitations imposed by the SEC, since in the mid-1980s I was, unfortunately, the person responsible for those. At a cocktail party in San Francisco after a speech about the subject and a grilling from the industry panel, an actuary backed me up against the wall, kept me there for about 45 minutes as he went through glass after glass of wine and berated me for the position, and telling me over and over the SEC has no business regulating the levels of insurance charges; the market not bureaucrats should be regulating the amounts of these charges. Believe it or not, I agreed with him. I agreed with him then, I agree with him now, but I was in a different position before.

The problem that the staff people have of letting the market regulate the level of charges is that they're tasked with enforcing a statute that has rate limits, namely, a 9% sales load limit on periodic payment plans, and variable annuities and variable life are regulated as periodic payment plans. The second statutory problem comes because of the two-tier structure. The separate account is virtually always regulated as a unit investment trust, and the insurance company is deemed to be its depositor. Ordinarily a unit investment trust is just a very passive sort of vehicle, and the depositor is someone that Congress viewed as capable of ripping it off. So the payments out of the assets of a unit investment trust to a depositor or an affiliate of the depositor are prohibited other than certain at cost administrative charges.

Now as usual, things that are prohibited can nonetheless be done if you do them right. The way to do it is either comply with an exemptive rule or get an exemptive order. The concern that the staff has about these charges is: What are they for? The reason the staffers need to know what the charges are for is to be sure of what they're not. The staffers need to be sure that the charges are not a sales load. In the case of an M&E charge that's a good question. In the case of administrative charges the solution on the exemptive standards was somewhat easy. It was just an at cost representation that the charge was represented to be no more than the

expected costs of administering the contract, and it is you people out here who will be on the hook for the validity of that estimate. So when some of the marketing folk want to lean on you for calling a little more of an administrative charge and a little less something else, keep in mind that it's you and not they that will be responsible for it.

When you look at the M&E charge there's a real problem, and that is as an SEC staffer you're going to see 15 basis point expense charges and 35 basis point expense risk charges. The risk that this at cost 15 basis points won't be enough is deemed to be 35-45 basis points. I've seen that. That tests the limits of the SEC staff's gullibility, believe me it does. The industry said you can't regulate insurance charges, but when I was a staffer, I used to argue that begged the question. The question is, is it an insurance charge, not whether the staff should regulate the amount. Now how could the staff be sure that this M&E charge was not a secret sales load? Well, there were two rules of thumb that were used as exemptive standards. The first was, if you were within the range of industry practice of the amount of this charge, a staff person would agree to treat it as an insurance charge. In other words, as long as you stay within that range, we won't argue about what it's really for.

The second and more difficult rule of thumb was used when you weren't within the range, when you started getting up there with some really high charges. This was many years ago. Reasonable meant in relation to the risks assumed. Now that turned out to be a very amorphous standard. I read a few memos, but I couldn't believe them. They would read words, words, words, words, therefore, number. It was a leap of faith that I was unwilling and unable to make back then, and so we decided that particular rule of thumb was ineffectual. So the limit came about, and we said the limit of our gullibility is going to be the top end of the industry range, let's determine what that is. I sent a couple of our financial analysts through our file drawers and checked out every variable annuity filing we had in our drawers and what the M&E charge was, had them determine a median and a mean, and it came out that one of those, I can't remember which, was 100 basis points. The other was 101 basis points. The entire industry fit between 75-125 except for a very few mavericks on either end, and we decided to say that's the range of industry practice and above that 125 we stopped being gullible. So 125 isn't the limit, it's the last number the staff will believe without making you prove it, and proving it is very expensive. No one ever chose to call. If the industry felt the staff was bluffing, no one ever called because it takes several years and hundreds of thousands of dollars of legal fees that we lawyers would love, but I doubt that any of your companies would love to test that out. It was easier just to price it within the 125 amount.

Now before you blame this as a function solely of the problems with attorneys, let me tell you an anecdote that was repeated by the SEC staff in a public meeting to the commission, so I'm not telling any tales out of school here that haven't already been brought out in public meeting. There was an actuary talking to an SEC inspector, and apparently he thought he was talking to his friend, because he was talking about a product that had an 80 basis point M&E charge, a relatively low M&E charge by the standards that we have discovered, but he offered the information to the inspector that the "real risk" taken in mortality and expense risk area was eight to ten basis points. That sort of hit home. That made the staff look at this as much more

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likely to be linked to the contingent deferred sales loads (CDSLs) that were beginning to become prevalent. So it began to appear more to the staff people that this was not an insurance charge. They had been had. From my point of view at the time, I wasn't going to go back on prior deals and try and rewrite them, but I wasn't going to let these charges go any further. As far as changing the statute, I think it's fair to say that the existing staff would probably share the view that the statutory limits are inappropriate and that perhaps they should be changed. Perhaps there shouldn't be any 9% limit. Perhaps the charges should be regulated as if they were passive unit investment trusts and subject to all the restrictions on Section 26. Just let the market determine what will sell. Let people charge as much as they want, and the consumer will ultimately turn down the ones that are too expensive. You need to change the statute to do that, and the staffers have, in fact, a year ago approximately this month, proposed doing just that. Is it going to happen? Probably, but my guess would be that we'll be in the next millennium before it actually gets done. It's a very slow process. The staff has to recommend to the commission. The commission has to decide. It has to then submit a proposal to Congress. It goes to committee and it goes forever. So I think in the near future we're going to have to continue to live with the limitations of the existing statute.

Now there are a number of ways to get asset-based charges out of a product. There's the administration charge that can come out on an at-cost basis. You can have your regular M&E of up to a 125 basis points, and there are two more ways that you can, in effect, go beyond 125. One is to designate the portion of your asset-based charge that isn't subject to an at-cost representation and, therefore, can have profit in it and that isn't within the 125 M&E, as a distribution charge or as going for enhanced death benefit, which I think you've heard John refer to several times in his presentation as a coming feature. Now the problem with designating it as a distribution charge is that it becomes a sales load. Now from the staff's point of view you're calling a spade a spade. No problem. The investor knows exactly what he's getting, and the drawback is from your point of view: you will have to be able to monitor it one account at a time so that, if aggregate deductions for this charge ever exceed 9%, you shut off the faucet. If you think that can't happen, you can run the numbers. If you run it out there at good enough performance for enough years, it can happen.

There is a more interesting new way, and as far as I know, only one company, Anchor, has done it so far, but others I'm sure are in the pipeline. Anchor had a 137 basis point M&E charge approved with a notice in order in December 1992. The extra 12 basis points were designated as being for enhanced or stepped up death benefit. The two elements of this M&E risk charge were separately justified. For the first 125 Anchor just stepped up and said the same thing everyone's always said. It's within the range of industry practice for that sort of risk and it's probably true. Anchor said in addition we're taking this extra risk, and we can show you statistically that the amount we're charging for, 12 basis points, is reasonable in relation to those risks. Anchor then used computer simulation data and relied heavily on actuarial memos to demonstrate results to the staffers, who have no actuary by the way. When you're addressing the staffers, you may have some people that have some numerical sophistication, but there is no full-time actuary on the SEC staff. I think that 12 basis points is unlikely to be the limit of what people with active imaginations no doubt can justify. That's simply what the first one who got one through justified,

and I think in light of that it may be possible that you can charge just about whatever you want to charge and you think the market will bear in combined asset charges if you have an enhanced death benefit feature.

A second area, where in my regular practice I most frequently end up talking to someone on the other end who's an actuary, is sales load limitations on VUL products. Now those of you who have wandered into Rule 6e-3(T), the applicable SEC rule that covers pretty much all aspects of offering all products, be careful. When you read the sales load limitations, they appear to be clear. If they meant exactly what they said, they would be clear. They don't mean exactly what they say. I'm not meaning to be too critical. I'm part of the reason they don't mean exactly what they say. I was there when we realized the words didn't say exactly what they ought to say, and we began interpreting them as if they did. Lawyers do this all the time, and the problem is from your point of view, if you wait until after you have developed a product and a contract before your securities lawyers see it, you may have already had too much charge that needlessly was built in. If you think you understand sales load limitations, you may or may not understand them. One thing that will help you through understanding how the SEC approaches sales load limitations is the idea of a bucket. It was explained to me by the more experienced fellow who was in the office when I got put in at the top of it that, if you imagine a sales load bucket that's issued with each payment, it's the same size for everybody. It contains all the load you can ever have for that payment. If you gulp it right down that's a front-end load. If you sip that gradually over time, it's an asset based or a spread load. If you save it for a binge upon surrender, it's a deferred load. And if you pour it down the drain gradually drinking the amount left at surrender it's a CDSL. It's up to the company when, how, or whether to empty that bucket, but there's only one, and it doesn't change sizes depending on whether it's a front-end or rear-end load. That's where the problem comes in. If you don't have a rear-end load, you probably won't be as confused with 6e-3(T)'s sales load limitations as you will be if you have a big rear-end load. The biggest problem is in understanding how the refund rights that apply only to loads of more than 30% apply to a rear-end load. The problem was that the language was copied from 6e-2, a comparable rule that applied to scheduled premium products. Scheduled premium products, time, and payments received march along hand-in-hand, and so if time has gone by, payments have been received if it hasn't lapsed. That's the way the product works, so it was not fully appreciated that modifications of wording were necessary for a flexible premium product like VUL.

One other current event is telephone transfers and telephone redemptions. There is a letter dated April 19, 1993, from the Division of Investment Management to Matt Fink, who's the President of the Investment Company Institute. It talks about the disclosures you have to make if you do, in fact, have telephone transfers or telephone redemptions. There has been some disclaimer language in prospectuses that the letter would now term misleading; a very dangerous word, the word misleading. So if you have telephone transfers you may want to check your disclosure against that April 19 letter.

MS. DEBRA SUE LIEBESKIND: I have a question for Mr. Bethoney. You said that in different areas of the country your brokers sell different funds. Can you tell me something about the different ways they measure fund performance?

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MR. BETHONEY: I suppose they measure it by the relationship they've built with the wholesaler that markets those funds. It is a relationship business. In reality the due diligence committee at PaineWebber determines what funds are marketed at PaineWebber through several measures of benchmarks that they use to value whether it's a 15-year performance, or a 10-year performance, or a 3-year performance. That's not something a broker decides. The products are given to PaineWebber brokers through due diligence process of the mutual fund area. Similarly, those same processes are used to determine the kinds of underlying assets that are used in our variable annuities. Basically the success of those products is really a by-product of the relationship built with the local person marketing in that area. I think we all know that. I don't know if that answers quantitatively your question, but Morningstar helps, VARDS, and all the other stuff.

FROM THE FLOOR: I've got a question for Bob. One of the things that actuaries get concerned about with the distribution of annuities to the stockbroker is, of course, what happens to the business at the end of the surrender charge period. On fixed annuities we're starting to see some experience. It's varied, but there is, obviously, a spike-up in the lapses. On variable annuities it's really too early to say. I don't think we've really hit that period, but what's the prognosis? Are there any differences in variable versus fixed from your perspective?

MR. BETHONEY: Are there any actuaries who market products to PaineWebber? We certainly don't play the Blues Brothers roll them, roll them, roll them, but I think if you took a look at our literature and our campaigns, I've been around too long to think that you can build a business with marketing section 1035 exchange procedures. We probably have the greatest persistency average among stock brokerage firms at PaineWebber, at least since I've arrived there. I'm going to be also involved in setting up a program where, if we don't think it's in the client's best interest to 1035 a product, we're not going to pay the broker a commission. It's something I had begun in the H firm in my autumn days there. I never got a chance to really promote it. One other thing I mentioned and I quickly passed over and I'd like to go back to it, those of you who market with us know and, John, you know this, that we deliberately pay additional money for people who put add-on premiums into the variable annuity. One, add-ons perpetuate the surrender charge because there are very few annuities out there, other than I think Metropolitan's product and one or two others, that have the surrender charge start at issue and then end at some point in the future, notwithstanding additional deposits. We are promoting add-on premiums. We think that once you buy a product, just the same way you buy an automobile and eat at the same restaurant and shop at the same haberdashery, that you eventually have an emotional tie to that product. Therefore, we had an add-on campaign that pays the broker more of a commission to add-on to an existing product than we would on new premium.

Second, we believe in dollar cost averaging, and that's why I would refute only mildly the assertion about catastrophic events in the markets analogous to October 1987. I believe that, if you promote that dollar cost averaging, if you promote consistency of premium payments and not just a one-time investment, you'll enhance the persistency that I think all of you are actuarially assuming and pricing for with these huge surrenders that will occur at the end of that surrender charge period.

The other thing that would enhance persistency is the levelized commission paid on an accrued value. I don't think you build the relationships by going after existing business. Proof of that further is that I refuse to do business with a company, that I'll leave unnamed for this meeting, that built its whole marketing cost on let me use the word *subsidizing* rather than rebating the surrender charge, that the client would incur if he or she surrendered away from another product. We're on record as having done that. Those of you who have dealt with me know that personally.

MR. VRYSEN: Let me just add one thing to that. I guess at North American Security Life we started writing both fixed and variable products in 1987 with a five-year surrender charge, and so 1992 was the first year we saw some of that stuff coming up. The business was not really maturing, but the surrender charge had expired on that block of business, and we did notice a significant difference between the fixed and the variable business. They were written as separate products at that time as opposed to a combination product. Now part of that is a combination with the level of interest rates. People who bought in at 8% before now are renewing at 5% and just looking for other options. I think it's safe to assume you get a better chance of getting better persistency at the end of the surrender charge period on a variable product than maybe you do on the fixed product, so that's from our experience.

MR. ALAN L. IGIELSKI: My question is for John Fenton. It may be a little early, but I wondered if you have seen any trends emerging with corporate owned variable life insurance.

MR. FENTON: Well, we really have to talk separately between the registered and nonregistered product. I think on the registered products to start that, as I was saying before, I really saw most of the early applications and more core marketing applications. So now I think we're seeing some products and illustrations that are being designed for that particular marketplace. On the nonregistered products, it's really an emerging market. There's not that many companies that are active in it. I think that the variable products are attractive because the ratings are less of a concern. Obviously, the low interest rate environment tends to push people over into variable. So I don't know in terms of any particular trends because I think it's so predominantly in the low load basis there's probably less differentiation between a fixed product and a variable. Most of the margin is in the COI, so I think it's too early for trends. I think the trend really is the products are just being used in that particular application.

MR. VRYSEN: I have a question for John or Bob if you want to take a stab at it. John, you might want to take a stab at this first. You indicated I think 40-70% of all the variable annuity sales were in the qualified plans. I've had people ask me this question: Why would somebody in a qualified plan buy a shelter within a shelter? Why do you need an annuity if you already have a qualified plan?

MR. FENTON: First, I guess the specific figure for the industry is about 57% of the variable annuity sales are qualified. Each particular market - I think I listed them earlier - is different, the IRA rollover, 401(k). The Tax Sheltered Annuity (TSA) really has to be sold through an annuity, so I think that's a big part of that. In terms of the 401(k), there it's really sold in the smaller-sized groups where you're really rolling everything into one particular vehicle. So when you get the larger case sizes there, it

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makes sense to have separate fund managers. I think it's really an all-in-one package at the smaller size.

MR. BETHONEY: We respond to that issue by saying there are built-in mechanisms for providing the client with a lifetime of income if he so chooses, and also, the death benefit is a critical issue in the qualified plans using a deferred annuity inside of a qualified plan. Again, to underscore John's point about having a plethora of choices within essentially one package is the third and probably the least focused on by us when we answer that question. There is a death benefit, a built-in mechanism, that is, the annuity purchase rights to provide an income for life if a person chooses and, last, the management of the assets.

MR. VRYSEN: I think those are all issues, but that's a very commonly asked question. The market does show that there's a huge market for qualified plans out there, and there's nothing wrong with writing an annuity within a qualified plan.

Let me just make one final comment then here to respond to a comment John Fenton made on the reserve aspects. I know this is a products session, but I guess reserves are a key factor that come into play in the pricing. It was mentioned that Sheldon Summers in California put forth the proposal in 1992 that companies hold the full account value for variable annuities. He was I guess somewhat in a stand alone position. That was not an industrywide feeling. I'm involved with the NAIC advisory group that's been looking at this, and I've talked to a few different people. It appears that the consensus is not to go in that direction, and it looks like the advisory group is I think going to recommend that the reserves for variable annuities basically utilize the spread, the M&E charge where you project forward the valuation rates and then set as a type A product. There's a contract spread in M&E charge so that you take your valuation rate minus your spread. That becomes your projection rate, and then you set a cash-value floor, and the cash-value floor is important on that tune. I think that was one of the concerns in California where, if you have a cliff surrender charge product and you're not taking the fees into account and determining your reserves, you can quickly come up with a reserve that is inadequate. So I think that's the direction that the advisory group is going to head toward, and there seems to be acceptance at the regulatory level for that type of approach.

