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Survivorship Life: Nontraditional Markets and Applications

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Summary: In this session, panelists explore the features, uses, and market for buyers of survivorship life products.

- *What policy features are available and how are they used?*
- *How large is the market for survivorship life?*
- *Who sells it and how?*
- *What are the mechanics of the sale?*

Panelists discuss some strategies, partnerships, and sales techniques that have worked. They also discuss nontraditional opportunities and the regulatory impact of pending and proposed legislation.

Mr. Christopher H. Hause: This panel consists of, first, Greg Taylor, director of product development and consulting for ING Reinsurance. He's developed life insurance products, including survivor life, for reinsurance clients for more than six years, as well as for some direct writers for whom he has worked. He's been an ASA since 1989, a member of the Academy since 1990, and a member of the SOA's Underwriting and Mortality Survey Task Force. Greg will be giving a description of the basic survivorship life product, its evolution, the riders generally available, and the reason why those riders are needed.

I'm managing partner of the firm of W.M. Buchanan & Associates, an actuarial consulting firm in Overland Park, Kansas. I entered the actuarial field in 1976 and achieved membership in the Academy in 1981 and a fellowship in 1986. Until 1996, I worked for direct-writing companies in various capacities, most recently as a senior vice president and actuary of a company that primarily writes credit insurance in the Midwest. While there I oversaw the effort to distribute survivorship life through client banks. Since joining Buchanan & Associates I developed with Bob Littell the Dynamic Insurance System, which is an educational tool to aid in the understanding of life insurance products. As part of that project, we developed a benchmark product line that included survivor universal life (UL) plans. It basically polled all the cost factors, etc., for all the companies that we could get data on, giving us a mainstream survivor UL-type product. Most recently, we've released a Windows 32-bit survivor UL illustration system for a major midwestern company that does a significant portion of its business through banks, so we'll

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†Mr. Littell, not a member of the sponsoring organizations, is President of Broker's Resource Center in Atlanta, GA.

definitely be working with them to see how the technique works. I'll be talking about marketing survivor UL or survivorship life products through banks and walk through a little case study.

Our third presenter is the guest speaker, Mr. Robert Littell, owner and principal of Broker's Research Center in Atlanta, as well as principal and cofounder of Second Opinion Financial Systems, a company that provides software training consulting services to the financial services industry. Bob's a past president of the Atlanta Chapter of CLU and the Chartered Financial Consultant (American College) as well as past chair of the National Association of Independent Life Brokerage Agencies. He chaired the initial six field organization task forces on technology and now serves on the board of the Insurance Agents Online Network. He is a member of the Risk Appraisal Forum, a national study group on impaired risk and special risk underwriting. Many of you probably are familiar with Bob's writings, most notably in *The National Underwriter*. We're very pleased and very honored to have Bob here. Bob's going to talk about some nontraditional uses for the survivorship life insurance product and share some of his experience.

Mr. Gregory T. Taylor: Basically, I'd like to talk about some product-market data; where the market is going with survivorship life products; different product designs, their history, and what the current typical designs are in the marketplace; the purpose of the product, which Chris and Bob will get a lot more into in their presentation; target markets, historically where the biggest target markets have been and, going forward, where our products are now being marketed; and the different riders on joint and last-survivor products—those of you who have developed or worked with them realize that they're often special and very important to the product sale.
First of all, I want to talk about where the actual businesses have come in to joint and last survivors over the last three years. As far as policy count, it's been about 1% of all policies written in the U.S., but if you look at it based on face amount and premium, it's been significantly higher than that, mainly because the average size of joint and last-survivor products is quite large. Often these large dump-ins are movements of assets into joint and last-survivor products, so there are high premiums in the earlier years as well. They've been steadily increasing in the last few years. This data comes out of *Best's Policy Reports*, and I think in September it comes out again for the full year 1998. That's for half of 1998 and we'll also get through June 30, 1999, so our impression is that eventually this will stabilize at some percentage, but it has been increasing over the last few years significantly.

Average face amounts also have been increasing. A lot of it we can attribute to bigger estates, more inheritances, and maybe even in the planning process on the marketing side of determining actually what would be needed in the future for estate-planning purposes. In the first half of 1998, it was in excess of $1.5 million for the average age. And the average age of the older insureds for new insurance policies has been steadily declining. A lot of that has been due to a bigger focus on the younger age market. It may be a pre-estate-planning purpose—more concern over having enough assets for the children when both parents die—but also a lot of it is related directly to estate planning, with younger couples having a lot more assets. At least for the first half of 1998, the average age of the older insureds was 55, and it was well into the 60s in the early part of the 1990s.

Now for product design. There are two main designs currently in the marketplace. The first is fixed premium products. This could include interest-sensitive whole life (ISWL) or participating WL-type products. They typically have level premiums with a level death benefit, although there's a special rider that I'll talk about in a little while that goes along with participating WL products providing joint-term coverage to create a level of premium for the lowest amount. That was originally designed to continue with UL products in a high interest rate environment, so now a lot of these participating WL plans are a lot more competitive in the current interest rate environment. Typically, the products originally developed had a jump in the cash value after the first death. That was changed and now the Frazierized method has become one of the only types of product in the marketplace. UL products are the other type. They came along in the early 1980s with single life UL products, and they're the predominant form of products in the marketplace today, with some of them having a variable design, but most of them still having the traditional fixed-asset option.

The jump in cash-value product came first in the 1970s, and it was actually a different product before and after the first death. Before the first death, there was a premium that was meant to fund the basic coverage of the risk of both insureds dying, plus fund the increase in the cash value upon the first death. There was also a premium for simultaneous death risk, but after the first death, it essentially became a single life coverage and worked exactly like a single life policy. It was confusing in the sales process, but along came Bill Frazier, who was a coworker of mine at ING Reinsurance in 1977. He developed the Frazierized mortality method and published a paper in *The Actuary* in early 1978. But, according to Bill, in the next four years nothing much happened with it. It just floated out there. Some companies looked at it, but it was not implemented. A lot of it was probably because of fear that the regulators were not ready to accept it, but there was slow acceptance both by the regulators and product development actuaries, so by the early 1980s, half of the products used the Frazierized method and today virtually all products in the marketplace use that method.

This is the basic concept behind the Frazierized method. It's a dual status policy. You can have either both insureds alive or one, so you come up with a mortality that reflects either of those two statuses, and there's no bump in the cash value upon the first death.

As another product design, variable UL (VUL) represents about 25% of the products in the marketplace. Obviously, it has the same attributes as a regular VUL product, except that it's based on a joint survivorship mortality. The other type, which is not common at all, is term life. The main reason it's not popular is because most products were developed at the time that UL was popular. It was viewed that the cash value would be a competitive advantage and just having that decreasing net amount-at-risk was viewed by insurance companies as a favorable product design.

The typical designs today are UL, VUL, or a participating WL policy. They all use the Frazierized mortality method. Cash values are often used at the sales time, which is a comparison between products, but the actual cash value itself is viewed not to be that important on an ongoing basis because the purpose of the product is for the death benefit.

We've seen more and more preferred underwriting classes in the marketplace. There were several products in *Best's Policy Reports*. I didn't review all of them, but probably about one third of the products have preferred classes and we'll probably even see a higher percentage in this week's study.

As Chris and Bob will show, the purpose of the product is mainly for estate-planning purposes. And the death benefit upon the second death is meant to cover estate taxes above the standard deduction, which is $650,000. Part of the requirement is to create a trust outside the estate in order to have the transfer be tax-free.

Regarding our target market, we're now looking at a segment in addition to older married couples, which is younger married couples. Some of that is related to the types of riders that are more attractive to younger married couples, but also just a drop in the average age is the biggest focus on making the products look or compare well to other products in the marketplace at the younger ages as well.

From the Floor: Are the products that are currently out there in the market only available to married couples?

Mr. Taylor: Companies typically have them available to any couples and to businesses as well—any two insureds—but the primary purpose is for estate planning for married couples. Then again there are differences in the types of riders that are attractive to single-income versus dual-income couples. For business deduction purposes, it is marketable to businesses and partnerships and there's also a growing segment for charitable giving for part of the benefit, not only to fund estate planning or estate taxes, but also as a charitable gift.

There's a wide array of riders. Some are specialty joint and last-survivor riders and some are just important because they're a counterpart to the individual-life-type riders for the same purpose. But one of the important ones for the survivorship life market is the policy split option rider; the need for that is in case of divorce or significant tax law changes. It allows the policy to be split into two individual policies and it can be either premium paying with no evidence upon split, nonpremium paying, or whatever is provided once the policy is split. The main market is married couples, but there are tax law changes. I guess the death benefit can be taxable in certain business situations, which may make it an attractive rider for a business sale as well. If one of the insureds is uninsurable, it's typically not available, although it can be available to split for the one healthy insured.

The first-to-die rider has become more and more popular. One of the purposes of that rider is to pay up the basic policy upon the death. For dual income couples it's important, even through businesses, to have that basic coverage paid up when the first insured dies. A counterpart, which is not too popular anymore, is a paid-up-at-first-death rider that would automatically pay up the basic coverage upon the death of the first insured. There are also single life term riders for a single income couple, with term coverage on the one insured. Or, if you have one healthy insured, you might want to provide additional coverage just for that person in the case of his or her death.

The second-to-die term rider is the one I mentioned before. I think it's called an econometric sale. That's where you're buying paid-up additions and term insurance under your WL product. What happens is that the dividends, as they buy paid-up additions, essentially replace the term insurance you have with the decreasing term product, but it ends up being level when you add the paid-up addition to the term coverage. Again, that would be a way to compete with low target premiums on UL products.

The simultaneous death rider is obviously a rider that's just for the joint market. If both insureds die, it provides an additional benefit. Sometimes it's specific premium paying, but most companies view the risk as small, and it's often just built into the base coverage.

The estate preservation rider is very exclusive to the joint market. It all goes with the policies that are known by the trust. If death occurs within the first three years, then it's deemed a taxable death benefit because it's viewed as a contemplated death. If both insureds die within the three-year period, it's typically a four-year benefit just to make sure that that entire three-year period is covered.

The maturity extension rider has become pretty common on joint products. Typically, products were designed so that they would invalidate at age 100, but if that endowment was taken it would be a taxable benefit. This rider is meant to extend the death benefit coverage past age 100 so that it would be nontaxable when it's received at the time of the second death. But there are a lot of questions surrounding that over whether the IRS will eventually take a stand on that benefit being taxable or not. It's a rider that's developed with a lot of caveats as far as how the IRS will react to it.

Waiver of premium, or cost of insurance charges, are the same as on individual products. Typically, you want to be insured as specified for the waiver coverage, or you can buy it on both insureds and this waives either the specified premium or the cost-of-insurance charges upon disability. Accidental death rider provides individual coverage. The target for that and the waiver of premium is typically younger couples because the waiver typically only goes up to age 55. And accidental death benefit coverage is also more targeted towards younger age risks because the accidental death cost becomes so large at the higher issue age.

There are two types of cost-of-living riders. One is tied to a cost-of-living-type index, and the other is just a fixed amount of coverage such as 10% of the initial death benefit increasing for ten years, so you double your coverage after ten years.

From the Floor: Is that without evidence?
Mr. Taylor: That is without evidence, right. And if they denied election, it could be similar to a guaranteed insurability option, where they denied election and the coverages went away as to future risk.

The last rider is also similar to the individual life counterpart, which is the accelerated death benefit rider. Typically there's a limit of $250,000. I'm sure there are a lot of variations in the marketplace, but it's usually a small portion of the total last survivor coverage.

Here are some special pricing considerations in developing survivorship life products. Many times there are high premiums in the earlier years, so there's typically a lot of sensitivity testing on premium outlays for both level premiums and lump sums. They want to make sure that there are profits under all types of scenarios to premium.

Impaired risks are a lot more common. Uninsurables are accepted a lot more often on one life—typically an uninsurable on one life and then a limit, Table 4 or Table 8, on the healthy insured. Naturally, underwriting expenses are higher because you're using the higher amount and also because you're underwriting two lives. Also, in determining mortality, you want to consider heartbreak syndrome, which is the death of the first insured to decrease life expectancy of the remaining insured; insured decline and joint accident risk; joint automobile accident risk; or any type of accidental death risk that would involve both insureds.

Spread of risks may be limited. There are companies that have developed them but have not written a lot of coverage. But certainly in the pricing stage you want to anticipate that you may get concentrations at certain ages that may not be as great as on the regular individual products, so you want to make sure you do a lot of sensitivity testing and distribution.

Lapse rates historically have been and are expected to be low, typically less than 3% in later years and even in the earlier years as well, but you want to beware of splits and specialty splits followed by tax law changes, because then you have to consider the needs for gifting a product for estate planning.

For loans and partial withdrawals, again, the cash value is important at the initial sale for comparisons, but the utilization rates are often quite low since the cash is just there. Again, it's a tax shelter.

Mr. Hause: Are there no lapse guarantees and how long are they? Have you seen a lot of that?

Mr. Taylor: From what I've seen, if they're there, they're quite limited. There are not a lot of long-term, 20-year guarantees on joint and last survivor products, and certainly with XXX on the horizon we don't see that as important for competition.

Mr. Hause: Now that you know all about the product, at least the traditional uses of it, I'm going to walk you through an effort to sell survivorship life by financial institutions, more specifically, banks with trust departments. Please bear in mind that other affinity markets are certainly available and can be explored through simpler methods, so those of you who have an eye on a different market may at least get an idea of some of the general approaches and some of the things that we've learned.

It's not an unusual sales process, except that it involves a middle person, that is, the institution. The bank in this case establishes interest at the institution, sets up a presentation or a seminar, if you will, follows up on the interested prospects, sells the individual on the plan, sets it up, and then monitors it yearly. This is especially important with regard to large estates, tax laws, change of estates, and other changes. I can't stress how important that yearly monitoring is. A number of additional opportunities can come up when you visit that insured year after year.

How do you create interest at the institution? We used four basic approaches. One is we took advantage of our existing relationships. Since I worked for a credit insurance company, I had a relationship with the head loan officer of consumer lending, but it could well have been another vice president, a director, or an officer. We used that as the direct approach. We used pre-approach letters, stimulating interest, and then follow-up calls. We also did cold calling in those areas where we had a strong presence. We were able to get in contact with people in a position of authority and then every once in a while we found out that a sponsorship by a local merchant or a personality was helpful. That may have been infrequent, but we found that that was successful at identifying and getting people to show up actually at the seminar.

This is where you ask, whom do I approach? First of all, you start with the people you know or the people who you have contacted to begin with. The people you want to get to, of course, are those in the trust department, the president, and all the other officers and directors. You want to involve as many people in the bank as you can. There are two reasons for that. First, banks sometimes are like other financial institutions in that sometimes the person who appears to be able to make a decision isn't really the person who is able to make that decision. That's why you want to involve as many people as you can. Find out who can authorize it. That might sound very simple, but you can waste a lot of time and effort chasing down somebody. You get a go, and he or she goes to his or her boss and tries to sell him or her on the concept. That's not the way to go about it obviously.

Second, is to get everybody in the same room and hit them with everything that you have. The word-of-mouth method is almost detrimental in that someone who has a preconceived notion about you setting up a seminar or talking to his or her customers will immediately start to resist. Get everybody in the same room, hit them with everything that you have, get a consensus, and then proceed.

When you talk to them, ask, “Why would these financial institutions participate in that? Why would they let you in there to talk to their most valuable customers and try and sell them insurance?” This is probably how it’s going to be perceived.

Public relations is important. Obviously, these are the banks’ most valuable customers. They should be interested in providing as many financial services as they can. Create goodwill and community standing by inviting all your people. That should increase your standing in the community. The communities that were more successful with were communities of 30,000 and fewer people. They have a lot of self-made fortunes in rural America, a lot of very illiquid estates: people with multiple heirs, illiquid estates, and limited access to financial advice. Those are the reasons that we concentrated on the secondary cities and the outlying areas of major metropolitan cities.

There are other considerations, such as living trusts and beneficiary trust involved in the typical sale. These are estates where fee income, commission income, is based on various forms. We’re having to get a little less inventive than we were a few years ago, but there’s certainly some fee income on the sale of the insurance products available. Last, you may find that this brings in additional business when a local business owner comes in, and it may generate other business for the bank.

So now we agreed to set up and hold a seminar. We’re going to invite all the people with net worth of note to the bank—more than $1 million or some other criteria. What does the bank have to do? What do we have to do? You have to provide a meeting room. It’s going to be sponsored by the bank. It’s going to be a bank seminar and the insurance company, the sales institution, or the sales organization takes second billing normally. Send out the invitations on bank letterhead. The bank follows up on the invitations: “Did you get our invitation? Oh, what do you think? It sounds like a good idea. I think you’ll find it informative.”

You need support for the seminar throughout the bank. This is why you involve everybody that you can because there are going to be some concepts that, if you talk to the chief loan officer and he or she says, “I don’t know anything about that,” and that individual has made contact with the bank, he or she will be less inclined to attend. If he or she does know about it and believes in it and says, “Yes, you should show up,” then that’s going to increase your attendance and the final placement of insurance. I can’t tell you how many times that we ran into a situation where our primary contacts in the bank were somewhat hesitant to recommend the final adoption of the plan. When the person knows the banker his or her whole life and says, “I don’t know, it’s kind of complicated. What do you think?” and the banker says, “Joe, these guys know what they’re talking about. Do it,” you’re going to get a lot better acceptance.

The sales organization’s responsibility is to provide the seminar, bring its people, and put on a slide show. Usually the presenters are technically competent. In my mock seminar that you’re going to see, it’s going to be a CLU and an FSA/CPA, but they have to be technically competent and good presenters. The people you’re going to invite are very perceptive. These are very shrewd businesspeople by and large. Be available for questions and interviews after the seminar. You have to be prepared if somebody jumps up and says, “Yes,” to stay there a few hours after the seminar because it’s likely that there will be one person who wants to get started immediately. You can’t tell him or her, “Hold it, maybe we can set up an appointment next Tuesday.”

We sent out the invitations and we have 35 people attending. Joe Blow and Daniel Boone, who have nice letters after their name, will lead the seminar. They're very technically competent and familiar with the tax law. You have a room full of 35 people who are all high net-worth people, and you're going to talk to them about how they can preserve their estate for their heirs. A lot of these people learn that other people couldn't care less if they leave anything to their heirs, but by and large people do want to pass on a significant amount to their heirs. This is what your heirs may face if you fail to properly plan the payment of estate taxes in large and/or illiquid estates. Multiple heirs in a family-owned business or a farm can cause some pretty serious distribution problems.

The IRS is just waiting. Events like death are income events for the IRS. They will get theirs. The challenge to you is to minimize the piece that the IRS takes and to maximize the portion that your heirs will inherit. What do we need? There's a need for cash, liquidity, and funds, on the death of the person, to be available to the survivors. I think we have an idea. Maybe we can use life insurance to fund that need.

This is a representative, but somewhat confusing, example. We have $1 million today and make a number of assumptions. Then, 10 years from now, your heirs get $1,567,000. But if you work with us and do a little planning, your heirs can get in excess of $2 million based on the same set of assumptions, although different if you did a little advanced planning.

Here are the options. We have no insurance plan and that same $1,567,000 goes to your heirs. That's the course you're currently on. You have $1 million, right? If you purchased insurance and it becomes part of your estate, that goes up (obviously purchase of insurance is a good idea) and you set it up in such a way that the insurance is outside the estate. You have the life insurance in an irrevocable life insurance trust, which is where you want to be. You've now maximized your funds. Again, this is tongue-in-cheek, but you do need our help in order to get this thing going. Here's how your estate planning goes. Begin with your starting assets. Upon the first death, You have an exclusion amount; the rest of it goes into a survivor trust. But right now what you do is set up a life insurance policy and get the premiums paid. You set up that life insurance trust. There's no tax on the amount coming in; this is how you maximize the income to your heirs. However, even though I know now that you thoroughly understand this process, you will still need our help getting this set up and kept up to date as the years pass. We'll keep an eye on the tax laws for you and have a little review every year. We set this up once. You will need to review it every year. If you have any questions, please fill out your evaluation forms. And thank you very much for coming and talking to us.

Don't forget to flash the name of the bank on every slide. Once again, you're representing the bank and doing it on behalf of its clients.

When the seminar is done, walk around and get your punch and cookies. You will have people coming up to you. They will be fascinated. You have to be able to set up the fact-finding interviews. Again, these must be held in the bank. This is where it gets a little bit tricky because many times these self-made people want to spread their money around a little bit. They don't have all their money in the bank, and they don't want Joe of the bank to know that they don't have all their money in his bank. So here is where you have to distance yourself in a very clever fashion from the bank and say, "This is a confidential fact-find. This will not be shared with the bank so you can give me all the information I need to properly set this up." You propose solutions that will be peculiar to their situation. What you do in the seminar is present more or less the classic case. Many of these people are going to have very specific needs. Some of them will need additional life insurance to begin with and business continuation—all the things that we've talked about. You then make the sale of the life insurance products. You might think that you're home-free, but, I'm sorry, I have a little more.

Selection of a company is very important. Household names are much better than nonhousehold names in this business. The underwriting process can really be an adventure and the timing can be quite extensive, as we'll find out in a minute. You also have an existing program because people usually are not walking around with-out any insurance at all. They usually have a local agent, a CPA, or a lawyer they're doing business with. You have to be very prepared to work with their existing advisors and not create a controversial situation. Once again, you need support from the institution.

You implement your solution by setting up a trust, placing insurance policies, setting up the gifting program, paying the premiums, and monitoring yearly. Obviously, with the new changing laws, that sort of thing is going to come into it. So what goes wrong? What should you watch out for? First, lack of support from the insurance company. The insurance company should be aware. It would be a good idea to let it know in advance what you're doing because you may have several applications coming through at once and turnaround from them is very important.

Second, lack of support from the bank. You may find that it's very excited at first to have this seminar, but then all of a sudden people are not sure. That means it's time to sit down again and reinforce the idea that it's good for them and their customers.

Third, conflicts with existing advisors. Sometimes you generate business for somebody else, although we had very limited exposure to this. You get the attendees all excited about it and then take it down to their local CLU and basically takes the business away.

Beware of hidden agendas. I ran into one situation where one member of the board of directors happened to own a large life insurance agency in town and wanted all the life insurance business to run through his agency. That obviously created a conflict.

As to the time frame involved, it can be six months easily between the time you hold the seminar and the time that you place the policy just because of underwriting delays. These people are usually busy to begin with.

I'm going to go right to premiums. Slow, but steady growth. We didn't see an explosion in the amount of premiums being sold in survivor life products from 1996 to 1997; we saw modest growth. We saw earlier that the average size is about $1.5 million, or $1.7 million now. This is kind of surprising to me. There is actually a significant portion—I think it's 10–12% under $250,000 and 40% under $1 million.

We talked about tax law changes. Up until 1998 the unified credit amount had been $625,000. I don't remember how long it had been at that level, but it's scheduled to go up to $1 million in 2006 and later. So that's the plan for the unified credit, which is the excludable amount.

We have heard talk about abolishing the estate taxes altogether, but abolishing taxes doesn't appear to be in the Washington bag of tricks right now, so I wouldn't hold my breath on that, but we could see increases in this unified credit amount.

Regarding other markets and affinity groups, I'm sure you have your own ideas, and your list is probably better than mine on this. Employers may have a board of directors or a group of highly compensated employees who need this type of planning. You may find that religious organizations—the charitable civic clubs and rotary clubs—may be a good affinity market for this. Obviously, there are different considerations and we don't have the trust as part of it, but perhaps someone on the rotary is, in fact, a banker. The general public could be a market. You can get a decent mass mailing list from certain types if you can hold your seminar in a public place. Use newspaper advertisements to target the wealthy individuals.

That is the end of my little spiel and my experience on what we've done in the Midwest through banks to sell survivorship UL. We did find that a pretty significant portion of the people were underinsured to begin with. We also placed a fair amount of basic life insurance, absent the survivor sale.

Mr. Robert Littell: I do appreciate being the nonactuary invited here, and I hope to talk to you about some nontraditional uses of survivorship, one that I think whose time has come. I want to also tell you a little bit about a couple of projects that I'm working on that I think are going to pump some new life into survivorship itself.

I wear a lot of different hats in the financial services industry, and, to a certain extent, I believe that some of the ideas and projects that I work on end up being a product of the fact that I am looking at things from so many different perspectives. That dates all the way back to when I was in college and had close to a triple major in anthropology, psychology, and political science. I always used to enjoy doing papers trying to look at things from all three areas, as opposed to explaining why a politician only makes a decision from a political standpoint. I've worked in a lot of different areas, anywhere from an agent to the head of advanced underwriting to a regional trainer. Eventually, when I came here to Atlanta, I did marketing for a company called American Agency, which was acquired by Life of Virginia. I went into the brokerage business and was there until about 1989. I then decided to get back into the field where now I wear a number of different hats. I do a lot of consulting, but what I'm really doing and having the most fun with today are four projects that I'll just mention briefly. Let me give you a glimpse of the model. Chris really has been one of the primary architects and has helped our team put together this concept of the Second Opinion Financial Systems into a computer model that is now available on the market called the Dynamic Insurance System, which allows you to graphically model life insurance policies pictorially and change any of the variables in a third of a second—the graph of the icon of the policy itself changes. We've shown this to a number of very technically oriented people who are surprised about how it really does elevate your level of appreciation for what changes in any of the factors and how sensitive any of our products really are to those changes.

One thing I might mention by way of clarification is that the estate preservation rider protects the transfer of an existing life insurance policy, not a new policy. If you do take a new joint and last survivor policy and put it in the irrevocable trust, you don't have the three-year transfer problem. You do have that problem if you're trying to use an existing policy. For whatever reason, if you want to transfer that policy, then you have the three-year problem, but if it's a brand new policy, as long as it's set up correctly, you don't have that problem.

The one area that I think is going to have a very, very significant impact on joint and last survivor is a concept called, the family incentive trust (FIT), and this is a concept that a tax attorney, ex-Arthur Andersen CPA Jeff Skoggen, and I have created that helps build a trust that is not tax-driven as much as it is character-driven. The idea is that the $7–10 trillion will trickle down over the next 20 years, and that's not counting the baby-boomer wealth. With the baby-boomer wealth, they're making that number as much as $20 billion that's going to be passing over to future generations. But what we have sensed is that there's somewhat of a change in attitude from the way that I and most agents are selling second-to-die insurance. The way most agents sell second-to-die insurance is, “Mr. Jones, you have a $5 million estate and you’re going to owe $2 million to the government. Why don’t you buy this $2 million second-to-die policy and put it in an irrevocable trust outside your estate so your kids can have $5 million? It will only cost you three to five cents on the dollar per year and you will be able to buy your life insurance by leveraging those premium dollars and taking care of your estate tax problem with discounted dollars.” That’s been the pitch. Part of the problem is that more and more people are beginning to question, “Am I really doing my kids any real favor by simply dumping $5 million in their lap?” This is especially true when the only handcuffs is that you are giving it to them in stages—so much at age 25, so much at age 28, etc.—and the balance after you think and hope they’re old enough.

What we have done in the FIT is to build a trust that encourages positive behaviors by building a number of incentives into the trust instrument. *National Underwriter* has acquired the marketing rights to it, so that package will be out in another 30–60 days. We think it’s going to have a very positive impact on the entire second-to-die market, and especially the charitable side, because almost every family incentive trust will have a charitable piece in it, thinking that one of the best ways to build character in children is to get them involved in charitable activities early in their lives.

For any of you who do have an interest in this topic, I have an article that’s appearing in the June 1999 issue of *On the Risk* magazine that takes up what may be one of the most important questions of the next 20–30 years, which is, what is going to be the trend between morbidity and mortality? The key issue is not going to be will we be living longer, but will we be living longer with longer active life expectancy or will we simply be making people live longer in some state of sickness that has profound ramifications for the long-term-care (LTC) industry? I don’t know if some of you had seen a couple of the articles that I had written in *National Underwriter* last year questioning the pricing of LTC products. I thought that it was pretty interesting that after those two articles hit, at first, there was absolutely no reaction. I thought we were going to get some irate letters saying, “You don’t know what you’re talking about; you’re not an actuary; we feel very comfortable with the pricing.” And after having talked with a number of pricing actuaries, every one pretty much felt the same: “We don’t have enough numbers yet; we really don’t know; we could have some of the same problems that happen in disability income where we really get hit by the hidden gotchas. What killed us in disability income was not the ones we saw, but the impact that managed care had on the specialty physicians. We didn’t understand that a number of those people would look at their disability income policies—not cancelable, I might add—as their future retirement plans.”

I believe that the industry has an unparalleled opportunity to look at and develop life products that will have either LTC riders or simply be a life product that’s only slightly massaged. Maybe it will not even be a full-blown LTC policy that will allow us to be able to do many of the things that we’re trying to accomplish with LTC by not calling it an LTC policy or not even having it be in some cases a LTC policy.

Part of this idea came about as I started to think about what it is that you need in a LTC policy. Many people don’t buy LTC policies because they don’t feel they are going to need it so they keep putting it off. People have a better ability to procrastinate over LTC than buying life insurance. It’s that it-won’t-happen-to-me-type thinking.

I got to thinking about the idea of designing a policy. Of course, the second-to-die policy is a classic chassis to build this thought on. Why? Because of its low mortality element and especially its low joint mortality element if you’re selling it to someone in their 40s, early 50s, or early 60s. This has been one of the key problems in selling LTC policies because the 70- and 80-year-olds have been the ones buying it. When I spoke at the 13th Private LTC Seminar meeting, I was very encouraged by the idea that that average age is coming down and some of the new movements that are offering incentives for people to buy LTC are having some benefits. Still, what I would like to propose to you who are doing product development, especially those who either may already have joint and last survivor policies, is to change the way you think about LTC. Think about a joint and last-survivor policy for a second. Stop and think about what that is. Because of the unique financial mathematics involved in the Frazierized method, it's a product for which nothing happens at the first death. What you have, in essence, is an accumulation vehicle, right? Because of the accumulation vehicle, the earlier cash values are going to be there because of the lower combined mortality. So why couldn't you design a product that in the first case would allow you to use it in the impaired risk market? Why in the impaired risk market? For one reason, there are a number of impaired risk situations that for LTC are uninsurable at standard rates. Adult-onset diabetes is probably the most classic example here. You have an adult-onset type II diabetic and the minute he or she goes on insulin with almost every carrier in the LTC industry, he or she becomes uninsurable for LTC. And, yet, depending on how much insulin they're taking and how bad it is, they might be either standard or only moderately rated. When you're assuming that the other insured is healthy, you might have a small hit to that accumulation.

Second, and it was mentioned before, the idea of a paid-up first-death benefit option that would allow you to pay the policy up at a first death, so that in essence what you have is a sum of money that's set aside in a pool that could be used for LTC. And notice I haven't even used the term LTC rider yet. Versions one and versions two can be sold without even a LTC rider and can simply be marketed as an alternative way to build up money in a life insurance policy that in essence could be used for LTC. One of the problems with LTC would be solved, especially if you were using this on a variable second-to-die chassis. People would buy the product. Why? For the investment savings supplemental retirement concept. By the way, it also will help you if, in fact, you have that LTC illness. And then, of course, we can talk about critical illness and LTC riders.

Let's take a look at some of the problems in the marketplace today and how this particular product designed in this particular way might help attack some of those problems. First, there's the agent retention and productivity problem. Any of you who are in agent building within your companies, the attempted agent retention business, know that we have problems out there on the agent distribution side. We have an aging field force, and we are having a very difficult time finding new agents and bringing them into the business. Part of the reason for that is, when I came into the business the cold-call ratio was make ten calls, schedule three interviews, and make one sale. Do you know what the ratio is now? Eight to three.

Stop and think. Call waiting, caller ID, voice mail. I don't know about you, but I know I'm a little nastier on the phone than I used to be. My patience level is lower; consequently working in just cold calls is becoming more and more difficult. When I came into the business, it was not unusual to find somebody who was an ex-minister entering the life-insurance business. It was almost as much of a calling as being in the ministry. The media, and partly because of the large number of rogue agents out there doing things, have certainly given the industry a bad name. The fact of the matter is we have a media problem today that organizations like life insurance are attacking and trying to reverse, but it's still a serious problem.

Also, job alternatives are plentiful. You're trying to get somebody into life insurance or to sell LTC when they want to do anything other than sell life insurance.

We also have a change in consumer attitudes. The consumer is unbelievably confused about LTC and how they're going to pay for it. It's amazing the percentage of individuals who believe that Medicare, not Medicaid, pays for LTC expenses. And, of course, the government is clamping down more and more on Medicaid spend-down.

I'm not going to go into these right now, but consumers are demanding the ability to control everything. They want content and consolidation. They want their information categorized. They're very cost-sensitive and price-sensitive today.

Finally, consumers are demanding simplification; they want their information filtered, prioritized, and personalized. What other problems do we have? We have this technology convergence, and I believe we have not seen what is going to become the major fact in technology within the next three to five years. That is what I call "when the world goes visual." I'm teaching a computer class right now in a retirement home where my mother lives. The average age is 87. Every class that I'm holding is standing room only. I'm only on my third class, and the retention level, the short-term memory, of a couple of the people in the class is poor. Some of them claimed they weren't at the first class when I recognized them from the first one. The point of the matter is Microsoft has put $1 million into SeniorNet. When things go visual, it will accelerate that because they'll be sitting there with what looks like a channel changer that will allow them to see something on TV, WEB-TV, or their computer and do nothing more than say, "Yes, I'll buy that for my grandkids," or, "Yes, I do understand I need LTC insurance." That's all they will need to do.

And, of course, the alternative distribution systems are out there with all kinds of challenges. Morbidity-versus-mortality trends will be a key question. Some argue that morbidity is not going to get better as fast as mortality and that LTC products on the marketplace today are underpriced by as much as a third. We could really be in some serious trouble when we try to raise the rates on these LTC products that we thought were guaranteed renewable but we have the ability to be able to raise rates, and the states find ways to put caps on those premiums. So I think there's a selfish reason for looking at this alternative way of using a life product as an alternative.

Finally, let's get into why it's the solution. First, an LTC product like this will be easier for senior agents to sell. The commissions will be better. The underwriting in many cases is going to be much easier. It's going to be a great reason to call on old clients. The media is beginning to support the need for LTC across the board. Life alternatives to LTC probably will be my talk next year at the 14th Private LTC meeting. You probably are aware that Golden Rule, First Penn, and now New York Life, have also come out with a life product alternative to LTC. And I believe that we're going to be able to get people to buy this product in their 40s, 50s, and early 60s. The prices are in many cases higher. If you can sell somebody in their 40s or 50s, they're almost equivalent to a 20-, 25-, or 30-year term policy premiums. It's going to be much easier to explain. There will be options, and we'll probably be working on graphic representations, to make personalization possible. I talked about convergence of technology. We're making illustrations that are going to be done on PowerPoint slides that will help show older people how these policies work. This will be an ideal system for a banking distribution system.

I mentioned the impaired risk, the paid-up, and the different approaches—critical illness and LTC riders. But most importantly for those companies out there who are already in the LTC business, I believe that this product with a life alternative will be an excellent addition. I would much rather as a salesman explain two approaches to someone and ask, “Which do you like better?” as opposed to, “Do you want to buy or do you not want to buy?”

The last comment that I’ll make, and this would get me shot if this were a room full of agents, I think this is an ideal product eventually to gravitate towards levelized compensation. We would make such a hit with the consumer press especially if this product were marketed to a seniors group that in fact were literally allowed to move the money from one pocket to another, which on a levelized commission, a second-to-die product would almost allow you to do it. So, as they say, that’s my story and I’m sticking to it.

Mr. A. Micheal McMahon: Chris, you talked about going into banks and smaller communities. It sounds like your approach was bank-by-bank, maybe a community bank as opposed to a regional or a national chain, where you might have to sell the national or regional headquarters first. Could you speak to that a little bit?

Mr. Hause: Yes, that was, in fact, the approach. Of course, we all know the community banks by and large are disappearing, so that may be a failed strategy with all the mergers, etc. going on. Actually, we’re seeing a bit of a different phenomenon banking-wise with the consolidations. We find that all the officers who have been displaced from the bank that got acquired go across the street and set up their own bank and take all their old customers back. I don’t think the community bank is dead.

Probably the biggest reason that we took that approach is our company’s prominence in the rural banking community. Being an insurance company affiliate that has a less than A rating, we saw that as a possible detriment. I think it was essentially, “go where your strengths are and go where your market is.” Not to say that someone like the principal couldn’t penetrate a large regional bank as opposed to the smaller community banks as we did. But I think many of the principles are the same. We offer the advice that I enumerated about the things that we ran into. I would imagine that you would run into the same things on a large scale in terms of decision making, support from the bank, support from top to bottom, those sorts of things. But I think, in my case, it was just a matter of where our strengths were.

Mr. Littell: Chris, in the rural situation with the smaller communities, what do you find with the banks that do not have a trust department or aren’t big enough to have a trust department? Are you still finding that there is acceptance of the idea of wanting to have some kind of commission income?

Mr. Hause: Yes, very much so. Yes, that’s a good point, Bob. If you do approach a bank or a financial institution, you must have that handy trust relationship available to you. We didn’t find that that dampened the excitement. Many times, in especially the smaller banks, the goodwill component and the ability to get their clients in a favorable light in presumably an educational-type environment was attractive enough to get the interest.

Mr. Littell: I hadn’t thought about it until you made that comment. One of the problems that banks are having today is the increasing liability that they are finding for irrevocable life insurance trusts, especially the old game of whose responsibility it is to send out the crummy letters to make sure that these letters are being done and done every year properly. So, in a smaller community situation, where the bank is only looking to in essence have a revenue stream, and the local attorney is, in fact, the one who is taking the responsibility of managing and watching this trust over the years, is in some ways a better deal for the bank in reducing their liability.

Mr. Hause: Right, and as we've found from time to time, sometimes these policies, particularly with the survivor UL that was sold seven or eight years ago, and their failure to perform as originally advertised has been a source of some embarrassment for the bank. That's something that we've tried to address with the Dynamic Insurance System and a point-in-scale projection. OK, now we're seven years down the road, let's recast and see what it takes now to pay up the policy. Many of these were sold on a seven- or ten-pay schedule intending to pay up after seven or ten years. That didn't come true, unfortunately, in this case, possibly unfortunately for the bank that could have participated in the sale.