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Session 32PD
Product Migration and Wealth Transfer

Track: Product Development

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Summary: What happens when an insured no longer needs current insurance coverage? This session explores customer life cycle needs and current issues with life and annuity products when the customer's needs change. The panelists also discuss the opportunities and risks associated with the migration of customers through products and wealth transfer needs.

MS. ANNE M. KATCHER: At this session on product migration and risk transfer, we're going to talk about some demographic trends shaping consumer needs. We're also going to go through an example of a company which had a customer need (in this particular situation, it's life insurance). We will take this example and show how a company went through the process in detail to address their particular need and how they developed a product and marketing solution to address the customer need.

We thought going into more detail with one example would be more useful to people, because each company's situation is different, so it's more important to focus on the process.. The focus will be to try to go about a creative process and find a solution to a consumer need. .

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discussion among both financial professionals and the client. A lot of his focus is to try to get feedback from both distributors and from clients.

Todd Henderson is with Western-Southern Life. He is involved with the Society in both the Education Exam Committee as well as the Risk Management Task Force. He's also involved with the Life Insurance and Marketing Research Association (LIMRA).

I am senior vice president in charge of life and annuity product design and implementation at AXA Financial.

MR. KENNETH J. GELMAN: I am not an actuary, but a researcher or a geographer. I'm going to be the set-up person for Todd's and Anne's remarks. I will provide some of the context for the discussion to follow by reviewing some of the broad range of consumer financial needs as they relate to product solutions that our industry provides. Do our products meet those needs that consumers have? Have those needs been changing recently? What opportunities are evolving as a result of those changing needs? I will also discuss the competitive and open environment.

I'll present the challenge to our industry in four themes through the presentation. First, we'll talk about consumer needs in terms of life cycles. Consumer needs are not static. Consumer needs change as one goes through various stages in life. There's a lot been written about it. It's nothing new to you, but it helps to look at needs when designing products in terms of the changing life cycle that consumers have, how that affects their needs and how they evolve over time.

Second, we're going to talk about retirement and retirement security. Certainly, that's become the key need and concern for consumers of all segments at all life stages throughout the country. It's been particularly telling to see this occurring over the last few years as people have realized at all ages it's up to them to take care of themselves. Anne mentioned we conduct a lot of focus groups and we listen to consumers. We listen to our clients and there's really a strong fear among consumers of outliving their savings, and trying to think of ways to protect themselves from that. We'll talk about how the retirement issue really drives and will drive a lot of product needs.

Third, we'll talk about how well our consumers are positioned to take care of themselves to make sure that they don't outlive their savings, as an example. We'll find that they're not in particularly good shape right now. We'll present some statistics to make that point. A key issue to discuss is our industry and the products that we've traditionally offered, including life insurance and annuities. Are we well- positioned to serve those needs, to solve that dilemma that consumers have? We'll present some research information that questions our ability, at least as far as consumers perceive us, to meet those needs. So that's the challenge.

Let's consider the life cycle of consumers going through their lives through adulthood and pinning that up with needs that fit with products that we provide. We have top risk coverage needs by age segment. Different needs pop up at different points in one's life. Some continue throughout one's life. Some have ebb and flow. That is the point of the life cycle, being aware of how things change. People will say it's a pain in the neck to have to apply for new products at different points in life. Wouldn't it be great if a product could be transferable and could be shifted around in terms of the needs that are satisfied as needs change? Some of the genesis for product migration really arrives from the basic finding of needs as they do change.

In the early years, consumers are looking for basic mortality protection, life insurance. They tend to be heavy into credit, so there's a lot of concern about ability to repay loans. For instance, they're beginning to apply for mortgages. Disability issues come in as, obviously, a consumer becomes fully established in the workplace and becomes a key breadwinner, usually around the age of 30 or so. People think about retirement income protection early on in their 20s. They're also concerned about protecting their assets. Home, auto, basic liability and those types of needs continue through time. Critical illness protection comes in the later 30s. Lately, in their 40s people are talking about and thinking about long-term care. As an example, there is the sandwich generation phenomena, where they see issues with their parents who are aging and begin to care for children and parents simultaneously. Once they get into their 40s and 50s their parents are in their 60s, 70s and 80s, payout after age 60, wealth transfer and estate planning then come into play. Extended asset protection is the last concern. People have bought second homes and have additional assets to protect. Extended asset protection is in terms of umbrella liability. A variety of needs ebb and flow, change in intensity through one's life. That is the key theme.

We talked about the basic concept of life cycle and needs as they change through one's life stage. Now, let's talk about the three pillars of retirement. There has been a lot of discussion and much written about the three pillars of security. Traditionally, the pillars have been the government providing Social Security, the individual through their own savings, and a corporation through pensions and/or defined benefit plans. What's happened with these key pillars? Those pillars have been crumbling, in particular, in the government and the corporation sides.

For general demographic trends, we have seen unprecedented aging of the global population. The increasing percentage of the world population over age 60 has been staggering. The estimate is that in seven years from now 28 percent of the world's population will be over 60 in age. Almost every region throughout the world has witnessed that increase. By the year 2050 in every continent of the world at least 20 percent of the population will be 60 and over. It's predicted that 36 percent of Europe's population in 2050 will be 60 and over. The result, of course, is eroding the viability of traditional pay-as-you-go retirement systems.

Currently, the percentage of people 65 and older as a percent of those of working age is at least 25 percent. In 2030, in countries like Italy and Germany, it's going to be over 50 percent. The aged or the senior population will be over half as a percentage of the working-age population, so you won't have that base to support Social Security anymore.

As you know, employers have migrated from defined benefit to defined contribution pension plans. Soon, the defined contribution as a percent of overall plans will pass defined benefit plans. Over 50 percent of the pension assets will be in defined contribution plans just in about a year or two from now. That, again, is evident worldwide.

So where does that leave the individual? On their own. A full 92 percent of consumers agree either somewhat or entirely that it's going to be up to them. They're going to have to bear the responsibility for their own retirement savings. As we said, the awareness that retirement savings is up to you has been increasing among all age groups, even among younger ages. The percentages are higher, as you can imagine, among people in their 50s. Over 50 percent of the people say that the most important concern they have is retirement savings. But even among younger people in their 30s, the percentages are at about the 35-40 percent level. This is how consumers are responding when asked what are the concerns you have in terms of your finances. So 35-40 percent of people in their 30s are saying saving for retirement is their number one concern. It's the highest indicated answer of any issue. Retirement savings is a concern for everyone at all ages. It's increase in intensity is the message.

Even among those who are the most affluent are very concerned about retirement savings as well. These are people who come from households that earn at least $100,000. People are talking about ensuring a standard of living during retirement years. They're worried about maintaining the same level they had while they were working and are concerned that they might fall below that level. The natural response, as you could imagine, is increasing the amount of dollars at an exponential level of monies going into retirement accounts. There is $5 trillion in individual retirement assets throughout the United States as of 2000.

The cost of living has been rising in retirement. On top of everything, for the people who want a comfortable living in retirement, it costs more. When you look at the index cost of living in retirement, there are huge jumps.

These are consumers who were saying they're very confident that they'll have enough money to do the following things. A lot of consumers are confident that at least they'll have enough money to take care of their basic expenses. Staying at that comfort level, taking care of medical expenses and paying for long-term care are three things that consumers are particularly concerned about. They'll have enough to live on, but will they be as comfortable as they were while they were

working? Medical expenses are higher. Long term care, whether it's for my spouse, my parents, or me is a particular worry.

Are people prepared? These are the financial black clouds on the horizon. As you know, this past year there's been a net worth decline in U.S. households. That's been the case for the last couple of years. The reason the real net worth of households has declined is largely a function of stock market performance, of course. The flip side is more and more household dollars are going into credit, so the debt service burden has increased. There are concerns in terms of how people are taking care of themselves.

In Canada, a low percentage of consumers own individual disability income (DI). In the United States, a high rate of homes are being uninsured or are insured below their market value significantly. Only half of U.K. consumers expect a comfortable retirement. Almost all Japanese consumers believe their retirement program to be inadequate. Australian small businesses are uninsured or underinsured. No matter which insurance need coverage you look at, there are significant gaps in different parts of the world. Is the industry doing its job in communicating, educating and getting consumers and businesses to insure themselves sufficiently?

What do consumers think about our industry and our products? Not that much. We're not really on the radar screen. When you look at attitudes toward life insurance, the statement was people should have some form of life insurance. From 1980 to 2000, the percent of people who don't even care has tripled. The percent of people who agree has declined.

What about some of the different products, some of the different investment and annuity products? Do people know about them and what do they think about them? The knowledge and perception is not that strong among consumers for annuities and life insurance products. Compare that to 401(k)s, mutual funds, stocks and bonds where the knowledge claimed is much higher and, related to that, the perception is higher as well. The two go hand-in-hand.

At my company we've periodically done what we've called IQ tests among our annuity clients in terms of the knowledge that they have about various aspects of annuities. Typically, they fail. These are people that have just bought and own annuity products. They don't really understand all the aspects of an annuity, what it can do, what it can't do. I don't think that's a surprise. If you look any of the literature, I think it's a complicated product and consumers don't understand it that well.

FROM THE FLOOR: What do you think the perception would be right now on 401(k)s?

MR. GELMAN: The positive product perception would probably go down. We haven't done any recent research on how far it would go down. People understand

the products. They understand the reality now more harshly, I guess, than before. We've done some qualitative work. People haven't indicated that their perception of the product, per se, has declined that much. Their interest in investing right now has certainly dropped. At least from what we've heard, their perception would go down significantly. They're willing to put money in, but I think there's still a strong belief in a consumer's mind of the underlying value of investing in equities and, certainly, of having a 401(k), again, because there's nothing else. It's up to them. They have to do it. Shifting their allocation to a fixed fund in a 401(k), certainly would happen, but it is not having a negative perception of a 401(k), itself.

Consider the prices and variety. What do I mean by that? When it comes to the solutions that we provide, consumers read a lot about expenses for annuities compared to mutual funds. The press perceives variable annuities, in particular, as being a more expensive product. They question the value of it versus mutual funds from a cost point of view. Then when you ask people about what's best suited as a product that guarantees retirement income that can't be outlived, again, because of the market environment through 2000, mutual funds are viewed much more positively than income annuities. This may change, and it may fluctuate, but there was perception of value in mutual funds versus income annuities.

What do the numbers look like? Annuity sales were up dramatically in the 1990s. But you can look at it from another point of view and compare it with the whole retirement asset outlook in the United States. When looking at the whole group, 31.7-31.8 percent are the shares that annuities have in terms of total retirement assets in the country in 1994 and 1999, respectively. Even though the annuity assets virtually doubled in that five-year period from 1994 to 1999 from about 670 billion to 1.4 trillion, the whole group grew similarly. There was a lot of growth outside the annuities sphere, in addition to the annuity growth itself, but there was no increase in relative share.

When you look at the sales growth for variable annuities, certainly it looks strong. However, the majority of the growth has come from money moving around. Are we really creating new capital within this space? You might not say so. The focus of the products, as you know, has been on deferred annuities, not the immediate annuity. We haven't been talking about annuitization with our customers or our clients. We've been talking about the investment focus of the product.

Our end point is that all the aspects, the pillars of retirement security have begun crumbling. The government, the individual and the corporation are all at risk. Think back to the life cycle about consumers in terms of life stages, evolving needs, their desire to have a comfortable retirement, the concern about having enough money for retirement, the concern for covering their risks during their working life, but help them to begin to think about savings and protection pretty early on in their working life, meaning in their 20s and 30s. They should not be waiting till their 50s and 60s.

MR. DAVID T. HENDERSON: A recent article in *National Underwriter*, titled "Preserving Assets While Providing Higher Transfer Value to Heirs and Charity" talks about the asset preservation toolbox and lists a single premium immediate annuity (SPIA), guaranteed death benefit life insurance and then long-term-care insurance. The product that my company came up with has a little different emphasis than that, but it covers the same focus—estate planning and effective transfer of assets. As Anne mentioned, my company just recently introduced a package of products to target estate planning solutions. We're going to be talking about the efficient transfer of capital at death. As she stated, we ended up with a life insurance contract. It's probably just going to be issued through one of our subsidiaries, which is the Columbus Life Insurance Company. Columbus Life caters to the upper and upper middle income client. We try to be very disciplined in our product development process, and only time will tell if that discipline served us well here.

I'm going to break my discussion into two pieces. First, I will discuss our research and what it told us about what this market holds and how it shaped our product development process. It essentially led us to develop a single premium universal life contract. I'll then be discussing the design considerations that need to be addressed in the development process for a product of this nature. I'm purposely not going to be discussing in great detail taxes or the use of trusts. There are experts in these areas. I rely on these folks when I need them, but I'm clearly not one of them.

We're going to be talking about wealth transfer, and that's the efficient movement of capital from one generation to another. For the most part, the current holders of that capital come from a group that was young during the Depression. Many of them were born into the Depression. During early adulthood, they saw the sacrifices that were necessary for several wars. They were frugal out of necessity. Later, many of them worked for a single employer and many of these companies grew to be huge corporations and employees prospered as the companies grew. Many of these people found at retirement that their defined benefit plans were maxed out. A lot of these people who would never, ever consider themselves to be rich found themselves meeting many, if not all, the definitions of wealthy when they retired. You probably know people like this. Many of them have talked about their desire to leave a legacy to the next generation.

Before we started our formal research into this product offering, we did some brainstorming on our own. We brought our marketing and our product design people together and we also hired a consultant. We evaluated at 50,000 feet the need in this marketplace as well as the limitations and the opportunity to satisfy that need. More than 30 million Americans are over the age of 65 in the United States. It's been predicted that about $10 trillion will transfer from this generation to their heirs over the coming years. The assets that we're talking about in this market are definitely significant.

Many people in this category also find that they have the means and the desire to leave a legacy, either for the benefit of their children or their grandchildren or for the

benefit of charities or other causes that they supported during their lifetime. Of course, we wanted to look at the need to accumulate or maintain these assets in a tax-efficient manner.

While the need is apparent, we have to look at the limitations that we'll be facing in trying to satisfy that need. A lot of these things relate back to what Ken was talking about earlier, although I think his emphasis was more on the baby boomers than this older generation. While many of the individuals in this older group do have significant assets, there is a growing concern among them that it won't be enough to carry them through to retirement. Now, depending on what mortality table you look at, the life expectancy for someone who's now age 65 has increased two or three years or more over the last 20 years for someone in that timeframe. That's about a 20 percent increase in a pretty short period of time.

Even though there may be a desire to leave a legacy, the likelihood that they will need access to these funds sometimes during retirement has increased. Emergencies will arise and life expectancy could further increase, putting even more strain on these retirement assets. Further compounding this situation is the high cost of medical care, drugs, tests and treatments that, of course, do assist in increasing longevity, but they do come at a high cost. The high cost of long-term care is also something that's been well recognized.

The bottom line is that despite the apparent affluence of many of retirees, there's a real concern that the cost of retirement is going to exceed the funds available. If there's no wealth, then there won't be any need for a capital transfer vehicle. Another limitation is that many of our nonlife contemporaries are also looking at this marketplace. To the extent that they are successful in penetrating it, that's just going to make it more difficult for us. However, I do believe that there's a real opportunity for those that can build a better mousetrap.

From our viewpoint, there's not a lot of penetration from life insurers, though I think we can provide solutions of which others might not be able. The tax efficient treatment of our products clearly makes them a very attractive vehicle for this purpose. We've already talked about the size of the assets that are going to need to be managed for this transaction. It's staggering. There's also an often overlooked, but I think very significant, benefit and that's the potential of developing customers from the receivers in the capital transfer transaction. If we can successfully help to make this intergenerational transfer of wealth take place, the beneficiaries of that transfer will become very good prospects for our other products. They'll have retirements of their own that will need to be planned for or incomes that will need to be protected.

So after looking at it from 50,000 feet we decided to go ahead and do the necessary primary and secondary research. On the consumer front, the most significant or compelling piece of information that we received or came across was from a LIMRA study that showed that a very, very large percentage of annuity

deposits are not annuitized or, otherwise, withdrawn during the annuitant's lifetime. I'm pretty sure the number was in the range of 80-90 percent, which is a very high percentage and surprised me.

But, clearly, if the intention at purchase was to leave these funds untouched during the lifetime, then I think that points to an opportunity for a life product to possibly provide a better solution. Personally, I think that number's probably high. I bet there are still a fair number of people who haven't yet died, annuitized or withdrawn, so they won't be in that final statistic. As these people age, the longer they live, I think it will be more likely that they will withdraw some funds out of their annuity. It is my opinion that it should push that number down somewhat, but time will tell. Nonetheless, it's safe to say that the amount of annuity dollars that are currently paid out as death benefits is very significant. Again, that points to a life insurance solution.

We also gathered primary research from the distribution channel. Columbus Life sells through a variety of independent agents or producers. We surveyed some of our top guys and we asked them to rank in importance the various features that are needed for a product in this market to be successful. By a narrow margin, guaranteeing the death benefit was listed as the most important feature, which is not a surprise. This is a death benefit sale.

A very close second was some access to the cash value. The consumer's intention is to leave the contract unaltered until they die, but they will want to be able to access their cash value in the case of emergencies, especially in a single premium situation. They'll want to see that a significant portion of the premium is still available after you take out early surrender charges and other charges.

The third most important feature is an extended maturity benefit. This was not a surprise either. The intent of the purchase is to facilitate a transfer at death, so any activity that's forced to take place prior to death would not be meeting the consumer need.

Fourth was compensation as far as being an important element in this product. It is important. We definitely need to make sure that we're providing enough compensation to the producers for the service they're performing. Further down on the list were things like the ability to pay multiple premiums and a long-term care rider.

We then turned our attention to products that were available in the marketplace. We did some benchmarking and found that there was no real consensus among the current producers. Some companies were simply using their shelf universal life (UL) or whole life product and turning the capital transfer transaction into a sales concept. Others had developed products specifically to meet this marketplace, while still others used riders to modify their base contracts. We saw universal life, variable universal life (VUL) and participating whole life. Some companies offered simplified underwriting programs, while others stuck to their normal underwriting rules and

procedures. The companies that did use simplified underwriting did so only when the initial premium was at a very high level, sometimes equal to the guideline single premium. We mostly ran across single premium products, ULs and VULs, but some companies do make multiple premium payments possible. The current stable of products really did not point us toward a right answer, and that was the bad news. The good news, I think, is that this lack of consensus provides an opportunity for an innovative and creative company to really make an impact in this developing marketplace.

Given all that we could determine through our research, and as we were stumped a little bit by the lack of consensus by providers, we decided to postpone our entry into this marketplace. That was toward the end of 2000. During 2001, we monitored the activity and still saw that there was no consensus coming through from providers, but it was felt strongly by our management and our distribution that we needed a product for this market. Toward the end of 2001 and the beginning of 2002, with all of the upfront research already completed, we started the product development process, the actual design. We brought the product out toward the end of the summer of 2002.

It's a developing market. But, hopefully, this discussion will aid in your thought processes as you develop your product, if you don't have one out there already.

I'm going to discuss the considerations that we addressed in the product design. The first consideration is the chassis. As you recall, our research showed that providers were doing a lot of different things in this area. Several companies used UL and whole life chassis. The attractiveness of this approach is that the base policies contain pretty strong guarantees. The whole life contract tends to contain a stronger guarantee, but a well-designed secondary guarantee attached to the UL contract can put these two designs on equal footing. The drawback of these designs is that they don't offer the potential high returns available through a variable product design. Looking at the variable products, clearly the multiple fund options will allow the policyholder to tailor their asset allocation to suit their best needs. Like all other markets that we see, this marketplace included insureds that had varying investment horizons and different tolerances for risk. The variable option or the variable product will provide them with that control, but it will also increase the risk that their end goal of efficient capital transfer might not be fully achieved. You can mitigate this somewhat with the addition of secondary guarantees, but you only need to look at the guaranteed minimum death benefit (GMDB) marketplace on variable annuities to get a feel for how expensive this feature might be.

If you choose a nonvariable chassis, either a whole life or a UL, I would look very closely at the asset strategy for the investments used to back the liability. It's probably a safe bet that the portfolio that you've built to back all of your other products is not the same basket of assets that you would use for a product catering to this older-age market. The capital transfer liability likely will be a little

shorter in duration than your other liabilities, given the high ages of the insureds. But, on the other hand, the persistency here is expected to be a little better, which would lengthen the liability somewhat. I definitely think that you'll want to do some scenario testing in your pricing. I would look at several different asset structures to make sure that you come up with one that is the best of the alternatives. Even if you do decide to back this liability with the same assets that you used for your other liabilities, I think that scenario testing is in order.

The decision to segment should also take into consideration the relative size of the segments that you can expect and, also, the complexity of managing many asset and liability groups. Some companies do an excellent job of reporting and managing many segments. If you aren't currently doing this, you'll definitely want to take a look at your accounting systems and your other systems to make sure that this complexity is something that you're ready to tackle.

When you look at the sale, I think that you'll find that you'll potentially be bumping up against 7702 limitations, so you'll need to clearly understand the tax tests to ensure that you won't be putting yourself or your clients in an unintended situation. Whether or not the product is evaluated under the cash value accumulation test or you use a guideline premium, you'll want to fully understand how these regulations will impact the funding capabilities of the product, especially in a single premium sale. You'll also want to think about the implications of the adoption of the 2001 CSO table. The funding ability is going to be impacted there.

The decision as to how to underwrite these contracts is one that we talked about at length. Do you want to subject these sales to your normal underwriting rules and procedures, or do you want to offer some sort of simplified issue? The word from our marketing people is that this product is viewed as an alternative to an annuity and that makes sense. If that's the case, you'll definitely want to take a look at the ease of issuing an annuity versus that of issuing a life contract. The net amount at risk, especially if you are in a single premium situation, can be proportionally small here. Many providers will require or do allow that if the contracts are maximally funded that they will use simplified underwriting. Clearly, a simplified underwriting approach is going to make it a lot easier to get it through the sales process. On the other hand, that should drive up your expected mortality, which would make it difficult for you to offer attractive nonforfeiture values.

The other end of the spectrum would be using your full underwriting rules. This will clearly make the sale more intrusive, but obviously it's going to allow you to better assess the risk. It will also give you the ability possibly to offer preferred classes, which is also going to make it easier for you to provide attractive nonforfeiture values at least for those folks that qualify for preferred.

If you allow for multiple premium payments, you will find that the early net amount at risks won't be relatively small. They can be substantial. So you'll want to look at full underwriting to protect yourself against anti-selection. One compromise that

you might think about is to underwrite strictly on the net amount at risk. That way you'd only be going to your most stringent requirements when the risk amount called for it. Clearly, the more you underwrite, the better you can assess the risk. Again, it will increase your ability to price with a lower mortality expectation at least for those insureds who meet the requirements.

Even if you use full underwriting here, I have concerns about the credibility of the mortality data at the older ages, which is the target for this market. You have to ask yourself if you have enough data in your current experience to comfortably fashion a good mortality assumption. I think that you'll want to study older age mortality data separately. If you're currently using a multiple of some base table to price for your other products, you'd need to ask yourself if that multiple is consistent across the entire table. My guess is that it's not. You could probably also find the insurers that will, potentially, help you with this if you feel that your exposure is not adequate.

I mentioned earlier when we talked about field force that secondary guarantees were a very important feature if the universal life chassis is used. I also mentioned that some companies were using their shelf UL product. If you head down this path you'll definitely want to examine your secondary guarantee to see how well it performs in a highly funded sale. Of the mechanisms that are used, if you use a simple, specified premium approach, you'll probably need an interest adjustment in the mechanics of that secondary guarantee. You'll want to make sure that that interest adjustment equitably addresses a single premium sale. Intuition tells me that a shadow fund approach, if it's designed well, probably handles this pretty well, but you'll still want to test the extremes to make sure that it's functioning as you'd hoped.

Many companies that we saw used the guideline single premium as the single premium required in order to get the guarantee. This is the highest premium you can put in the contract. Remember that the guideline single premium is calculated at 6 percent. Given the relatively low level of interest rates that are available in the current marketplace, I'd still think you want to take a look at what the cost of that guarantee may be, even at this very extreme funding level. One last thing about secondary guarantees that you'll want to think about is how your guarantee operates, if at all, in the situation where a partial withdrawal is taken out. If you recalculate the guarantee you'll want to make sure that the formula you're using is working.

Third on the list of important product features was extended maturity. You must remember that this is a death benefit sale, so you want to make sure that any sort of extended maturity benefit is working properly. You don't want to put your clients into a situation they did not anticipate at the time of sale. When you look at the population or the pool of insurance that you'll have, you'll want to remember a couple things. One, we expect them to be relatively persistent. Two, even though they're going to be older, if we underwrite, they're probably going to be pretty

healthy. If you add into this the possibility that medical breakthroughs could further extend the expectation of life, it could be very possible that 15 or 20 years down the line we find that a lot of extended maturity benefit options are in the money, so I don't think that you should take these things lightly. They've evolved over the years from ones that were of minimal cost to the ones that we have today in the marketplace that provide a significant benefit, but also have a high potential cost. You have to fully understand the mechanics of your extended maturity benefit and look at it under extreme investment and mortality scenarios and persistency scenarios. You want to make sure that the loads you're charging are sufficient to handle the possibilities that could happen 15-20 years into the future.

Looking at surrender charges, full surrender is not intended at the time of sale or a future surrender at all. People will be putting significant dollars into these contracts, and they will want some ability to pull these funds out should emergencies arise, so nonforfeiture values are going to be a basis for competing. A word from our producers is that people are looking at the potential to get their single premium back in a relatively short period of time, as little as two years. We benchmarked the current products that were out there and we found this to be fairly accurate. When we designed our surrender charge, we specifically tested it against this requirement. If you do this, you'll likely find that this will put some downward pressure on your surrender charges, reducing them. To the extent that your surrender charges are at least in part there to recover commissions, that will probably also put downward pressure on the amount of upfront commission you can pay. To mitigate this, you can move some of the commissions from an upfront payment to maybe an asset trailer or you could extend the commission recovery schedule further . Whatever you do, you'll want to talk to the distribution. You'll want to understand what their motivations are in the management or in the sale and the management of this contract. You'll also want to provide them with the feedback so that they can understand what the tradeoffs are between the commission schedule and the contract performance or at least the timing of that performance.

I've talked about both single premium and multiple premium contracts. Most of my discussion has focused on the single premium sale. It's simple. I think it's also going to be the most likely, although, the *National Underwriter* focuses on a different transaction in the article I mentioned earlier. It's easy to illustrate and also easy to compare to alternative solutions. Our marketing people expressed a very strong desire for our product to be able to handle multiple premium payments. If you don't find that request, you may get something along the lines of a request to expand your definition of single premium to all the premiums received within a certain timeframe. It makes sense, because when you read the *National Underwriter* article, you'll see that they're going to be using an SPIA contract to pay life insurance premiums. You may find that the funds that are earmarked to be placed in the life insurance contract currently exist in a number of vehicles. Each of those will be becoming available at a different time or they might have certain surrender penalties or tax penalties associated with them, currently.

Allowing multiple premiums seemed like a reasonable request, but I want to caution you that it can get relatively complicated relatively quickly. Things change for all sorts of reasons. Future premiums don't get paid. If you have secondary guarantees in these contracts, you'll want to understand how these guarantees adjust in this situation. On one extreme, the guarantee can simply lapse. At the other extreme, the guarantee could adjust to meet the emerging funding level. But if you choose the latter, that really gets complicated real fast. As I discussed earlier, if you do allow multiple premium payments, you're going to find yourself with a significant net amount at risk, and you're going to want to make sure your underwriters are comfortable with that.

I'll mention a few other considerations really briefly, because these really apply to any product development effort. The loading structure is very important. We've talked about the need for early cash values bearing a reasonable relationship to the premium. We've also talked about the need to make sure that you're adequately funding for extended maturity or providing for extended maturity. You'll want to test a number of loading structures to make sure that your end structure performs as you'd hoped. Reinsurance is something that you should probably take a look at, especially if you're concerned about the credibility of your older age mortality data. It may also help you in the current environment to be competitive, but then you're going to have some influence from the reinsurers on how you do your underwriting, whether it's simplified or full. Finally, you will want to explore the impact of adding various riders to this product and what that will do to its ability to meet its end objective, which is efficient capital transfer.

I've tried to address in a pretty short period of time the list of things that we think should be considered when you're developing a product for this market. I'm sure I've left some things out, but hopefully this will give you a better feel for the questions you need to ask yourself during development, or at least you've gained some comfort that you asked the right questions when you went through it. I still have a couple of concerns about this product offering. Though I think that the life contract can be an attractive vehicle in this marketplace, that partly depends on what eventually happens. If the insured lives for a very long period of time, it could be that some other option, like a deferred annuity, would have provided a more attractive benefit. You want to understand what I've called the crossover in years of when a pure accumulation vehicle would accumulate enough that it would actually provide a higher payout than the death benefit of the life contract if the insured lives that long. You also want to make sure that your producers understand this crossover when they are offering alternative solutions out in the marketplace.

I've mentioned a couple times the older age mortality. It's something that you need to think about. Are your underwriters comfortable evaluating this risk, and is your extended maturity option prepared for better than expected mortality in the early years prior to age 100? As with all sales of life insurance, I think that disclosure's going to be very important here. You'll want to make sure that it's adequate. You also need to be sure that there's some assurance that outside tax advice will be

sought. Finally, it's a concern with almost everything we do, but competition's going to be very high for this product. Cases are going to be spreadsheeted almost every time. They're going to be spreadsheeted both on the guarantees and also the accumulation value. You'll want to benchmark frequently to make sure that your offering stays competitive.

There is a challenge for those who want to be in this market. Judging by the different approaches that companies have taken, it doesn't appear that there's one right answer at the moment, but there's an opportunity. The predicted intergenerational transfer of wealth is significant if it occurs. The market will likely go to those that develop creative and attractive solutions. Are those solutions currently there? Do we expect there to be evolution in this marketplace? I think that's true.

MS. KATCHER: I think Todd has discussed in much of detail how his company provided a solution to an estate planning capital transfer problem they identified. It really doesn't just apply to his company, but it applies to many of the situations we're seeing today in that there are many opportunities that we may be missing. Other people are out there grabbing these opportunities or thinking about them. In the current expense environment for most of us it's very difficult to be thinking ahead about some of these things that are going to be very important three, four or five years from now. We may just be focusing on what our producers need now to be successful, and what are the things that they're looking at now. We definitely have the opportunity to step back a little bit and use some of the input that people are providing here to get ourselves thinking about this, because I really think that as experts in risk analysis that we have significant knowledge. The big challenge is being able to partner with marketing people who can take the risk aspect, take the consumer need that our market research has told us about, and package it into an attractive offering. Often that's partnering with the reinsurance company as well, because your company can't take on a particular risk.

Some companies have started to come up with things that have had success. For example, if we look at the immediate annuity marketplace, Fidelity has been selling over a billion a year in immediate annuities with its direct marketing. How are they doing that? Because they have a very simple product, they have a very simple structure and the customer service in terms of educating the client is really good. John Hancock has been successful with long-term-care riders, where many companies haven't gotten too far with long-term care. These are the kind of things we have to think about as we go forward—focus on the customer need, do your market research, and keep it as simple as possible.