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Session 76 PD
What's New with Equity-Oriented Life Products?

Track: Health

Moderator: Elinor Friedman

Panelists: Christine E. Dugan
Rhonda R. Elming
Noel Henderson Harewood

Summary: This session provides an overview of recent developments in the variable life and equity-indexed universal life marketplace. Topics include an overview of recent sales trends, enhanced guaranteed minimum death benefit guarantees, the emergence of living benefit guarantees on life products, developments in the equity-indexed universal life marketplace and innovations in distribution for equity-oriented products.

MS. ELINOR FRIEDMAN: My name is Elinor Friedman. I'm a senior consultant with the Tillinghast business of Towers Perrin in our St. Louis office, and I'm the moderator of this session. Our panelists are going to cover three major topics: innovations and distribution, indexed life and variable life (VL) products.

Someone asked me how indexed life and VL ended up in the same session. I was thinking back to it and remember sitting around the table with the Product Development Section Council, brainstorming for ideas for the spring meeting. We had a long list of ideas, a limited number of slots and an unwillingness to give up any of our ideas. Someone suggested combining indexed life and VL, and everyone agreed. That's how it happened. Upon further reflection, though, there has never been a better time to have these two products in the same session.

On the one side, we have VL, whose performance is directly tied to the equity market. But over the past several years, with the volatility in the equity market,

Note: The chart(s) referred to in the text can be downloaded at:
http://handouts.soa.org/conted/cearchive/NewOrleans-May05/076_outline.pdf.

carriers have begun to find ways to offer consumers more security through guarantees, such as guaranteed death benefits and even guaranteed living benefits (GLBs).

On the other hand, we have indexed life products, which are truly fixed-life products with all the guarantees that go along with that. However, in the low-interest-rate environment, indexed life offers some of the upside potential of the equity market via current crediting rates that are linked to an equity index. While these are different products, conditions have developed that have caused them to move a little bit closer together to satisfy the needs of our consumers.

To begin with, regardless of the product type, you need to find a way to incent people to sell them. Our first speaker is Christine Dugan, who is going to provide us with an overview of innovations and distribution of these types of products. Christine is a partner with Watson Wyatt Insurance & Financial Services in Berwyn, Pa. She's involved in many areas of life consulting, including life and annuity product development, mergers and acquisitions (M&A) and expert witness opinions regarding product design and suitability.

Following Christine, Rhonda Elming is going to provide us with an update on indexed life. Rhonda is the vice president of life product development at AmerUs Life Insurance in Des Moines, Iowa. AmerUs is the market leader in indexed life products. Additionally, it is one of the Top 5 companies in indexed annuity products. Rhonda has extensive experience in the index market. She developed indexed annuities for six years at ING before joining AmerUs in 2002.

Noel Harewood is going to provide us with a VL update and is a consultant with the Tillinghast business of Towers Perrin in our Atlanta office. Noel's primary areas of practice are financial modeling of life insurance and annuity products, specifically in embedded value and appraisal context. He also does product development and has done a significant amount of work in the modeling of distribution systems in the annuity market. With that, I'll turn it over to Christine.

MS. CHRISTINE DUGAN: As Elinor mentioned, I'll be talking a little bit about distribution trends, primarily with flexible-premium VL, which I'll call VL throughout the conversation, and I'll go into a few other areas.

A negative that we need to start out with is we're talking about a product line that has lost significant market share over the past few years. On the positive side, at least sales through 2004 weren't exactly plummeting, and we at least maintained the status quo relative to 2003 and may have even picked up on sales, depending on what source of trending you look at.

We did get some cash in the box. We certainly didn't get as much of the universal life (UL) capacity that fixed-account UL is getting, but let's start on a positive note for at least maintaining market share. Hopefully moving forward, we'll pick up more.

What I'm going to be talking about today are who has been selling some of the products that we have been seeing some sales in and what some of the marketing concepts are that have driven historical sales. Given the fact that we have sales coming from noncareer agency-type channels, we're going to talk a little bit about certain product innovations and service requirements that these other channels demand. Last, we'll go over some key factors that are going to contribute to the success of VL going forward.

Let's briefly look at the evolution of the VL market. Today's marketplace looks a bit different from that in the early 1990s when the product got started. The distribution was a bit different, and the concentration in the marketplace was a bit different. Primarily in the early 1990s, we had mostly career-agency companies selling VL products. Now, especially with a couple of the major players, we're seeing more of a focus on independent distribution. As far as the market concentration, you'll see that we definitely got some trending going over time.

For market concentration, what I'm looking at is the Top 10 writers of the product and how much market share they encompass. You'll see in 1990 that the Top 10 players essentially account for 89 percent of the business. In 1995 that went down to 69 percent, and going forward, we started trending downward, but then we stabilized a bit. That could have been for a number of reasons. One is when we get to 2001 and 2004, we're losing market share at that point, so I wasn't sure who was leading the way there. We obviously saw some dispersion along the way.

We look at the shift in distribution every time. If we look at the calendar year 1995, we see that we had a significant amount in sales coming from career agents (72 percent), a decent amount from independent producers (26 percent), and not anything from the brokerage channels and the banks. When we look at 2001, we see a significant shift, and we had more independent pickups going on at that time (37 percent) and started seeing some sales coming in through the brokerage channels (8 percent). For clarification, the stockbroker term is encompassing both the wire houses, such as UBS, Morgan Stanley and Merrill Lynch, and the regional firms, such as AG Edwards. They are embedded within that 8 percent of the split of the two, and for 2004, the wire houses encompass probably 5 percent of the 8 percent, to give you an idea of where the majority is coming from.

Dugan Slide 5 is a summary that came out of a recent Life Insurance Marketing and Research Association (LIMRA) survey that was performed in the 4th quarter of 2004. LIMRA went out to most of the VL writers and surveyed them in a lot of different areas. One of them was "What kind of concepts are you using to sell your variable products?" According to the responses, 100 percent of the companies who sell single life and variable universal life (VUL) use individual protection of the sales concept and the sale. Likewise, individual retirement planning came up extremely high. Those are the two obvious ones that we've seen for a long time. But you also see that a significant number of companies mentioned estate planning, deferred compensation, split dollar and executive bonus-type sales, as well.

On the survivorship side, nothing is too interesting. Obviously estate planning is one of the major sales drivers. You're going to see a lot of specifics throughout this presentation. A lot of is from the LIMRA study. I thought it was interesting to keep a perspective of who has been selling what and what the concepts were behind the sales.

To again get more perspective from the same LIMRA study, Dugan Slide 6 shows there's a majority of sales on single life and survivorship coming from individual customers versus the business sales side.

We've looked at some of these historical sales figures. We've looked at some of the LIMRA results and some of the Tillinghast value survey results. What do we see as far as emerging trends? Believe it or not, that baby boomer pot of gold is obviously influencing the VL marketplace. The same thing is happening on the VL manufacturing side, as well, and I'm sure on the indexed life side. I see a big opportunity here as far as positioning a product as an income-planning tool and part of a long-term retirement planning solution. We've seen lately a few companies come out with things like automatic income provisions, whereby you can designate a certain percentage of your cash value to come out monthly or quarterly. Those kind of tools will help position the product a little better as an income-planning tool. VUL or indexed UL could be seen more as accumulation and distribution types of products, and it's not purely an accumulation tax-efficient type of product.

I've seen some overload provisions come out, too, which I think position the product in a good vein from the same perspective: a long-term financial planning, maximization of income sale.

I've also seen some trends regarding persistency-type bonuses, whereby cost of insurance (COI) charges get refunded and lock you into the contract over time. For example, the product will say, "We'll return all of your COI charges 20 years into the contract, and by the way, we're going to stagger this out over a period of five to seven years or so." They're locking you in, and, again, we want to position the product as a long-term planning vehicle.

Reduced M&E charges have been promised from a couple of companies, whereby if you elect a long-term provision in the contract, you get lower M&E charges than somebody who doesn't elect that long-term provision and may have something to do with long-term care.

We're obviously seeing a continued focus on guarantees. I think the marketplace is still in this situation where people are a little bit reluctant to throw everything they have into equity market-related products, so as we've seen, things like the guaranteed minimum withdrawal benefits (GMWBs) and the VAs infiltrate and see the products through the income provision that I mentioned before.

We've also seen a lot of no-lapse product development and things of that nature coming from the 6UL side, which makes a lot of sense.

Given these emerging trends, how important are these related to our sales success going forward in VL products? If you look at some of the results from a recent LIMRA survey, again the same survey that was conducted at the end of last year, companies are asked to rank a few different factors regarding their importance in VUL sales: distribution, product features, fund performance, marketing and the core product. Distribution came up with an average ranking of 4.7 out of 5, which means that we've got a heavy skewedness toward everyone saying it was probably the most important feature for the sales success of the product. That's interesting, so I think we've all been involved in the question of which comes first: the chicken or the egg? Is the distribution more important, or is the product more important? I think the results of the survey are saying that no matter what you're doing, product distribution is king, although the product ranking of 4.3 still shows that people do view it as important, just not as important as distribution.

The LIMRA survey also summarized the breakdown by distribution channel, which is quite similar to the Tillinghast results I had shown you before. The results in Dugan Slide 9 are a little bit different because of the way LIMRA measures sales on different premium bases, but I think the recurrent theme is that we still have a significant percentage of sales coming from career agents and controlled agents. We're starting to get some more penetration in the brokers and the financial institutions, although not significant, but we've got some in there. That other category also includes regional broker-dealers, so we've got a little bit of a mismatch here with the stockbroker category, but the general theme is that we're getting into some nonagency channels now, which is good.

LIMRA also asked the VL companies what compositions of sales positions were included in their companies. You'll see that 67 percent of the companies responded that they had national sales managers, and 29 percent said they had national account managers. I won't go through each response, but deep down, one of the more important ones is external wholesalers, which 58 percent said they had, and internal wholesalers, which 83 percent said they had, so let's go into some of the wholesaler responsibilities now.

To reiterate, we've got roughly 80 percent of the writers saying they've got internal wholesalers. Roughly 60 percent say they've got external wholesalers. We've seen various wholesaling models throughout our careers. Some were great, and some haven't worked. There's no definitive number of wholesalers that works best. I think it has to do with who your end user is and who is doing the sale. For example, if you've got a targeted distribution that includes financial institutions and stockbrokers, those types of producers need a lot of hand-holding. They need constant product training and constant marketing materials. They need a lot of people available at any given time. If you got a distribution targeting at that extent, you're going to need a higher number. We've seen some of the primary sellers of VL having more than 200 wholesalers in an organization just to handle all those types of distribution channels. There's no magic number. It's just a matter of targeting a strategy.

I think the market leaders that are working through these channels have done a lot of strategy regarding the proper incentive to have, and the key to wholesaling is figuring out how much you have at fixed cost, meaning salaries for the wholesalers, and how much applied incentive you provide. Once you figure out that magical mix and use a survival of the fittest kind of technique, ultimately, you can get to a successful story. There's one strong VL writer right now that solved the puzzle, at least currently.

LIMRA also asked companies what the responsibilities of the internal versus external wholesalers were. Again, the general theme is that external wholesalers have a lot of responsibility as far as promoting the product sales, explaining the product to the end user and providing sales ideas, so there's constant hand-holding.

On a financial advisor channel, and here I'm using a general term because a financial advisor would be parallel to someone who spends most of the time following mutual funds and variable annuities (VAs), a lot of companies currently are viewing this as the big potential market for VL products. We'll have to see how that unfolds, but we have seen a lot of product development activity just focused primarily for this type of channel.

The compensation norm for financial advisors is smaller first-year commissions and a bunch of trails after that, so that schedule is a little bit uncommon for a lot of parallel life products, but it doesn't say we can't abide by it. A-share products probably work best. Again, we've got a bunch of disclosure requirements going on, so having a more explicit front-end load might help as far as suitability. Companies supposedly have had some good flexibility as far as negotiation of compensation. It's looking like a promising channel from a lot of perspectives. They've got clients who are savvy about self-account allocations. Once you hit this channel, your product's got to have a full array of subaccount options, but I think we've seen almost every company out there now with at least 50 subaccount options and different styles.

Regarding compensation, I've seen some alternative commission schedules pop up and some movement away from heaped first-year commissions. I have a couple of products out there that have levelized compensation. I'm not sure how they're performing yet, but they're out there. I've also heard of a couple of no-compensation products that are wrapped in registered investment accounts. That's an interesting concept. Again, there are increased disclosure requirements. I'm not sure where that's going to take compensation, but we have to abide by that.

The VA scrutiny that's been out there in the market has impacted everybody in the financial advisory sector. A lot of the broker-dealers are cautious now on how they approach the sales. It's always good to carry over to VL sales as well through that channel. A lot of people I've spoken to lately think that the increased scrutiny from the SEC and the National Association of Securities Dealers (NASD) is hindering product development activity and innovations in the product. I'm not sure if that's prevalent with all of you and what you've been doing, but I've heard that from a couple of major writers of VL products.

We had our first market timing issue emerge. NASD put down its first fine against the company for not having proper internal strategies in place to monitor market timing and any kind of excessive trading in its VUL subaccounts, so I think that was an interesting first for the VUL industry. It's not a good thing, by the way, but hopefully it's a random event.

Again, there's a need for transparency. That's the recurrent theme you'll hear about all equity-oriented products right now.

What do we see as key factors that are going to impact distribution success in the future for variable products, for VL and indexed UL? For the past several years, I think everyone has heard that we need to reinforce further the strengths of these products, that distribution doesn't even know about the strengths of the products, and that it's never been firmly educated on them. From the career agents to everybody else, more education is needed, and I know that sounds like fluff, but all the survey results that have been out there in the past few years point to the same answer. That's something that could help distribution success going forward, particularly with UL.

Other success factors are product innovation and servicing requirements for a particular channel and addressing specifically different consumer needs. An example of that has been some of the recent active money management options that have come out on different contracts. The consumer has got to make subaccount allocations, so it probably would be a good service for the companies to have some kind of ongoing advice on asset allocation. At least a couple of pretty large writers have come out with these kinds of positions lately, which don't even cost anything in a couple of the contracts, but I think it's going to help things move along nicely.

Regarding product simplification and the expedited sales process, particularly with the banks, this will never fly in the banks until we can get a sales process that is quick and doesn't differentiate much between customers. Lately we've at least seen a couple of middle-sized writers come out with products that are supplied issue, go up to a decent-sized face amount and have few medical questions but absolutely no medical underwriting. It'll be interesting to see how those types of products do in the banking environment. The banks could be huge, so that could help us going forward.

We need product education and support, especially with the stockbrokers. There potentially is a role for an intermediary here to get an external party involved, spend more time on that and make it a dedicated process. We'll see where that goes.

Given all that, the future of these products is still uncertain in my mind. It might be in yours, as well, but we've got a few opportunities. One is the probability of the product doing well in investment-oriented channels. Another is the impact of banks and other channels. The banks are a huge, untapped market. I've seen recent statistics where, of consumers surveyed in calendar year 2001, 50 percent of them knew about life insurance products being available for sale by banks, and when they did the same survey in 2004, 50 percent of them knew that banks sold life insurance products. The banks have not done much to increase awareness of the fact that they have life insurance products. If we can make a full-throttle effort there, who knows what that will provide in terms of sales success?

Regarding indexed UL products, there are implications. If indexed ULs take off like equity-indexed annuities (EIAs) have taken off, there's a question of which market share that is taken from. Is it taking a share from the fixed-account ULs, or is it taking a share from the VULs? I could go both ways with that. The annuity one was a slam dunk that was going to take the fixed-annuity sales, given a low-interest-rate environment. This is a little bit of a different story. I'm not sure what that's going to do as far as market share implications and the impact on distribution. You've got a lot of channels now that are extremely familiar with a difficult product, meaning the EIAs. I'm not sure how that's going to transfer over, whether they're going to like the indexed UL product, and hopefully Rhonda will make that clear to all of us.

The last but probably most important factor is the cooperation of the equity markets without some nice, old markets in the near term. Who's to say what the future of the product is going to be? Those are my comments. Next to talk about indexed ULs will be Rhonda.

MS. RHONDA R. ELMING: My topic this afternoon is the indexed life market. I'm going to start today with an overview of that market, and provide what I hope is supporting evidence that this market is poised for rapid growth in the near future. Then we'll discuss the product development opportunities for this market and some of the key considerations that are unique to indexed life products. In the end, I hope you walk away with some key insights into important issues that need to be considered in developing an indexed life product.

Indexed products are still relatively new in the marketplace. Indexed annuity products were introduced in the United States in 1994, while indexed life emerged in 1997. These products have great consumer appeal because they offer outside potential with interest earnings linked to an equity index, with downside protection via the underlying guarantees. These products are fixed products, so they're not registered with the SEC; however, although they comply with the safe-harbor requirement for nonregistered products, care must still be taken to make sure that they're not marketed as a security.

The indexed annuity market has experienced a growth explosion over the past five years. The compound annual growth rate was an astounding 44 percent, and the growth curve is already steepening. One out of four fixed-annuity sales is now an indexed sale. We expect life sales to follow this trend. Think about it in terms of the classic product life cycle. The indexed annuity market is entering the rapid-growth stage, where the indexed life market is still in the early-adoption stage.

There are several barriers to entry to the indexed life market, including administrative capabilities, investment expertise and distribution. Because of this, there are only eight carriers in the indexed life market today. But our market research indicates that there are several carriers that are getting ready to enter the market, including two large VUL players and several indexed-annuity players.

Sales in the indexed life market over the past five years have been relatively flat. We did see an increase in 2004 at 25 percent over 2003, to boost the compound annual growth rate to 18 percent. However, this is still only 1 percent of the entire $11.8 billion life market share. In 2004, variable sales were 15 percent of the market. UL sales boosted by secondary guarantee sales were 35 percent of the market, whole life sales were 26 percent of the market, and term sales were 22 percent. As Christine said, we believe the indexed life market is going to grow, but it's unclear as to whether it's going to grow the market or whether it's going to capture some of the VL market share or some of the fixed UL market share.

Why do I think the indexed life market is going to grow? First of all, these products offer an outstanding customer value proposition. As I mentioned, there's upside earnings potential, with interest linked to the growth of the specified index. In addition, the interest earnings potential, we believe, is going to be 200 to 300 basis points more than a traditional fixed-UL product over a long period of time. Once interest earnings are calculated and credited to the policy, they are locked in and cannot be taken away if the index declines in the future. Last, there are strong minimum guarantees, and we know now, after the bear market of the past few years, that customers are interested in underlying guarantees.

Second, I think there is increasing agent and customer awareness of these products, and that's going to continue to grow in the future, as we have new entrants in the market and the continued growth of the fixed indexed annuity market.

Third, these products meet consumer needs, particularly given the shifting demographics that are going to occur over the next 10 years and our older populations becoming less risk tolerant.

Elming Slide 10 gives some support for these products. Huge numbers of baby boomers are entering the years when retirement and wealth transfer issues begin to take center stage. They're transitioning from consumers to savers. More than 4 million people will turn 50 years old each year for the next 10 years. In addition, the savings rate is down, signaling a clear need for retirement accumulation. These are the people the indexed life products were designed to serve, people that are looking for upside potential with downside protection.

As consumer wants and needs converge to the middle, so must the product development activity in our industry. We see evidence of this happening already, with traditional UL and VUL carriers entering the fixed indexed market, and VUL products being enhanced with guaranteed minimum benefits.

With that, let's talk about the product development opportunities in this market. I see the product development opportunities occurring in two categories. The first one I've called "expanded product chassis" and the second one new "indexed crediting strategies."

Remember, indexed life products are simply fixed-life products that credit interest based on the growth of the specified index. This interest-crediting approach can be applied to any whole life or any interest-sensitive product chassis. As such, I believe that companies will soon be using the indexed crediting engine to drive a whole portfolio product that can meet a broad range of consumer needs. Most of the products that are available for sale today are on a flexible premium, UL chassis, although there are a couple of products that are on fixed premiums, excess interest, whole-life chassis. There are products that are geared toward cash accumulation, and there are products that are geared toward death benefit sales.

I wouldn't be surprised to see a second-to-die product in the near future that utilizes an indexed crediting methodology. There's already one large indexed annuity provider that has launched the single-premium life product. This seems to be a logical way for indexed annuity carriers to get into the indexed life market and capitalize on the success of the indexed annuity product. Single-premium life products are perfect for the wealth transfer market, and if combined with a simplified underwriting approach, may be attractive for both life and annuity producers to sell.

Given that the indexed crediting mechanism is the thing that differentiates indexed life products from traditional UL, I believe that the bulk of the product innovation or product development activity is going to occur in the area of new indexed crediting strategies. We've seen this materialize already on the indexed annuity side, where there are 35 indexed crediting methods and six indices currently available for use in the indexed annuity market.

However, indexed life products do have some unique issues that need to be thought through before an indexed crediting strategy can be developed. I'm going to walk through some of the key considerations as they pertain to hedging requirements, the cost of underlying guarantees of a contract and the illustrated rate basis. For each one of those issues, it's important for the product development actuary to balance product complexity with the value-added options of the indexed crediting strategies.

Before we have a discussion on hedging requirements, it may be helpful to review indexed product economics. Similar to traditional fixed-UL products, indexed UL products have a spread that we're trying to manage, too. On the traditional UL side, you take your net investment yield minus your product spread to arrive at the credited rate that's going to be applied to the policy. On the indexed UL side, those funds adjusted for the cost of the guaranteed return are used to buy call options instead of to credit a fixed credited rate. Credited interest on the indexed UL product is then funded by the proceeds from the call option.

In developing a new indexed crediting strategy, you need to consider how you're going to hedge the liability, and the goal is to replicate the embedded options that are sold in the contract. For example, you'd buy one-year call options to back an annual reset strategy. You'd buy two-year call options to back a two-year point-to-point strategy. Finding an appropriate hedge may be easy or difficult, depending on the complexity of the indexed crediting methodology and the index being used. That's why most companies today use the Standard & Poor's (S&P) 500 index as their underlying index because there's a viable options market supporting it.

Companies then use levers, including the participation rate and the cap rate in their products, to bring the option cost within their option budget. A key consideration in developing a new indexed crediting strategy would be whether or not the participation rate or the cap rate that you can afford to credit is marketable. Another consideration is the volume units needed to cost-effectively hedge, and I've been told that the volume requirement is somewhere in the range of $3 million to $5 million. Given the cash-flow characteristics of indexed life products are different from the cash-flow characteristics of indexed annuities, the periodic premiums can pose a challenge in terms of meeting the volume requirement.

Given these volume constraints, there are several considerations for indexed life products. First, what is the company's distribution strategy? Will we be able to sell enough of this product to be able to cost-effectively hedge it, and if sales are going to ramp up over a period of time, how are we going to manage the liabilities during that period of time where sales are still ramping up? What is the impact of offering multiple index strategy? Clients might be interested in having a variety of indexed crediting strategies to allocate their premiums to. However, each strategy requires a separate option. The more strategies you offer, you may only be deluding the notional amount that you have to invest.

How frequently should you buy the hedges? Some companies buy hedges only once a quarter, or even once a year, and this allows them to accumulate the premiums until they have a sufficient volume to cost-effectively hedge it. That sounds good from the hedging perspective, but from a marketing perspective, buying options only once a quarter or once a year might not be attractive.

Last, consider synchronizing product features to maximize effectiveness. If you have multiple products, or if you have products with renewal premiums, which most indexed life products have, consider the same options for your renewal premiums as your new premiums so that you can combine them to hit your volume requirements.

The second issue that needs to be considered is the underlying guarantees. The guarantees in these products are funded by the fixed-income securities that you're investing in to back the product. However, the cost of the underlying guarantees does impact the option budget and therefore will impact the participation rate and the cap rate that you can afford.

Today, minimum guarantees are often in the range of 1 percent to 3 percent on indexed life products. Regarding product innovation going forward, if you can develop a product that has an underlying guarantee structure that's attractive for the consumer and less costly for the company, you may be able to have a competitive advantage.

Yet another key consideration is the interest rate that should be used to accumulate policy values in the illustration. This is not an issue in the indexed annuity market because most companies don't illustrate their indexed annuities. However, in the indexed life market, everybody is illustrating the products.

Currently there is no prescribed method for calculating an illustrated rate or determining which illustrated rate should be used. Most companies will apply their indexed crediting method, coupled with their current rate, whatever their current participation rate is, or their cap rate, to historical indexed performance to arrive at an illustrated rate.

A 15- to 20-year historical analysis is most common in products today. The illustrative rate needs to be updated every time the company changes its participation rate or cap rate or any time the company updates its historical analysis. Each company will have to determine how frequently it's going to do that.

Care needs to be taken in terms of developing an illustrated rate because if you take an overly aggressive approach for coming up with an illustrated rate, you may come up with an attractive rate for marketing reasons but may increase the market conduct exposure on the sale of the product.

As with any product development effort, it's important to balance product complexity with the marketability of the product. In addition to the product indexed crediting mechanism, there are several other key considerations in developing an indexed life product. It's important that you engage a broad spectrum of people in your organization to discuss these issues and make sure that the product pricing, the administration and the marketing are all aligned.

From a product design perspective, some of the issues that need to be considered and discussed are how are you going to handle monthly deductions? How you're going to handle partial withdrawals? How are you going to handle policy loans? Is your product going to allow transfers? Some clients want the flexibility to transfer funds from one indexed crediting strategy to another. How are you going to accommodate that in your product design?

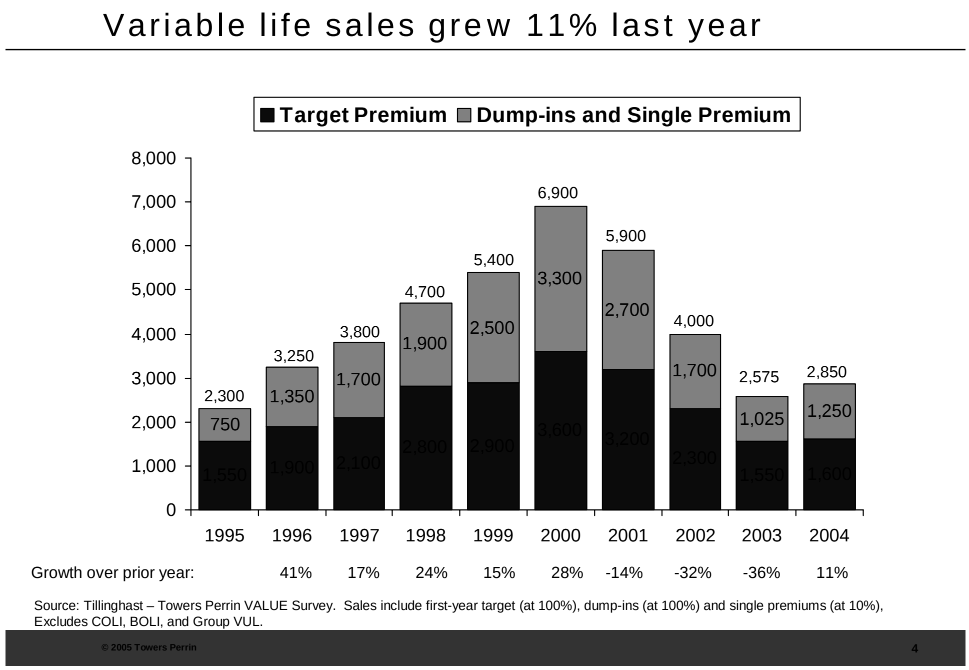
From an administration perspective, you obviously need systems support for the indexed crediting strategy and for the other product provisions. You also need systems support for the hedging strategy, accounting and valuation requirements and policyholder communications. If you are selling an indexed life product, I think you're going to want to take a look at your annual statement and see how you can enhance that illustration or that annual statement to include more information regarding how the interest earnings are credited.

Product education is always important, and Christine touched on this, as well. It's important not only to educate your agent on the product and how it works, but it's also important to educate consumers, so that you set expectations appropriately, and it's important that you educate your home office staff so that you can manage this product line effectively. Marketing materials, illustrations and annual statements all need to have adequate disclosure of the indexing mechanisms, as well as the illustrated rate basis.

In conclusion, the indexed life market is a growing market. We see more entrants coming into the market every day. With the shifting demographics, we do believe that product innovation is important to meeting those ongoing consumer needs, and it's important that in the back office you have all of your support together and aligned to have an effective management strategy. Last, product education can go a long way. Thank you very much.

MR. NOEL HENDERSON HAREWOOD: Basically we're talking about what's new in the VUL market, and I'll start with a brief market update of what's gone on recently. I'll talk about distribution trends, and then I want to talk a little bit about the product issues and trends that we're seeing out there in the marketplace.

The big news is that VL sales grew last year by 11 percent. Shocking and amusing are the only words we can use to describe that. It's the first increase since 2000, but that's good news. People are pumped, and things are looking up a little bit.



I have a couple comments on Harewood Slide 4. The first thing you notice is probably the steep decline after 2000 followed by the little tail. The second thing you'll see is that the decline is a little worse on the single premium than it is on an annual premium. This is an interesting story because it suggests that a lot of these things are probably accumulation-driven. We know the market suffered a decline from 2000 and 2001, and it has turned up recently, so I think the investment dollars aren't going into VUL as they were before. Hopefully, that's going to turn around.

Interestingly enough, these sales follow the equity returns closely with an appropriate lag, much more so than the VA sales. As you look at the VA sales pattern, you'll see a similar decline in 2001 but then modest growth thereafter, even though the equity markets were continuing to perform poorly. It's probably a reflection of the way the VA writers have used guarantees to keep the sales coming, whereas on VL, we haven't seen that kind of breakthrough as yet.

Let's discuss market share. Christine covered some of this, but VL sales have continued to decline. They held steady for the first time in 2004. It was 37 percent in 2000, and only 16 percent in 2004. A couple of things are going on here. First is that fixed UL, the problème du jour for the past couple of years, has taken up a market share and has been driven largely by the strong secondary guarantees in the market. We don't know for sure how much of that premium is secondary guarantee and how much is not. I don't think there's a source that captures that number, but we know that a bit of that increase has been driven by no-lapse-guarantee UL.

The second thing that we want to point out is that term has held steady over the years, but let me remind you this is the premium-based graph, and we know term prices have fallen quite a bit, so we're selling more term than we were in 1996 to 1997, but the prices have come down, so the premium doesn't fully reflect the increased volume of term sales.

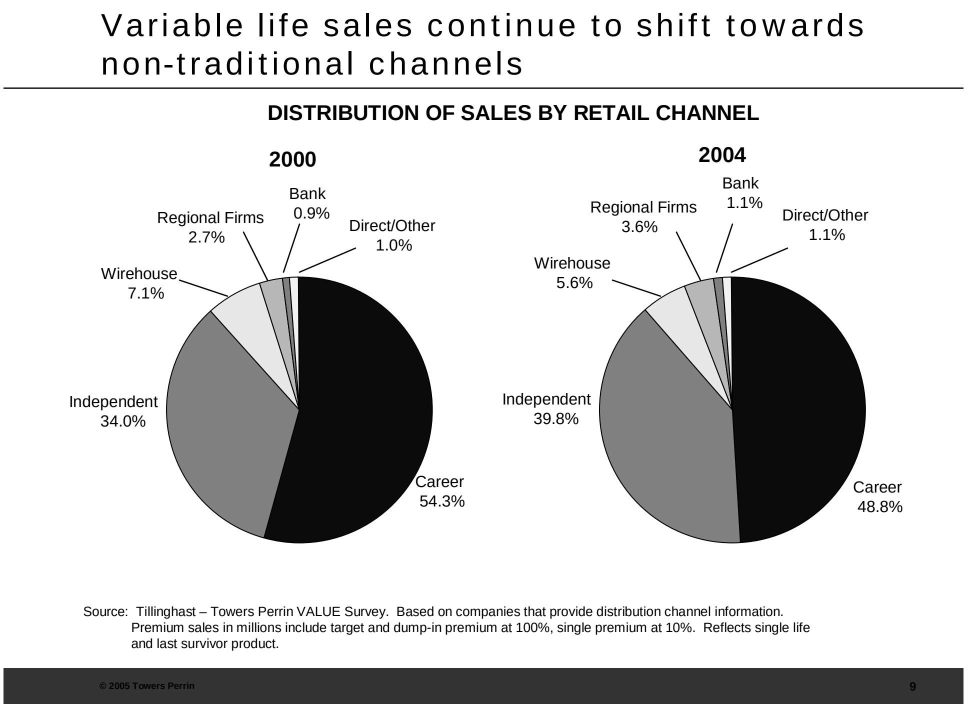
Rank			Total Sales ($ Million)		Market Share	
2004	**2000**		**2004**	**2000**	**2004**	**2000**
1	4	Hartford Life	305	396	11%	6%
2	1	IDS Life	289	591	10%	9%
3	3	Pacific Life	245	430	9%	6%
4	7	AXA Financial/MONY	163	352	6%	5%
5	6	Nationwide Life	161	363	6%	5%
6	2	Met Life	153	540	5%	8%
7	8	John Hancock	136	318	5%	5%
8	15	ING Life	136	142	5%	2%
9	>50	Allstate Financial	126	0.4	4%	0%
10	5	AEGON Companies	124	380	4%	6%
		Top 10 Total	1,837	1,581	64%	57%
		Total Market	2,850	6,900		

Let's look at the Top 10 writers according to the value survey. In this table we're showing sales in 2004, and we've been keeping track since 2000. I have a couple of comments. First is that the 57 percent is the Top 10 in 2000, so it's not in the sum of those 10 writers per se. I want to make that clear in case somebody does the math and realizes this doesn't work out. We see that there has been a little bit of movement, but eight of the Top 10 writers were also in the Top 10 in 2000, so there's a little bit of growth in some areas. The other interesting thing is that we don't talk about distribution channel here, but if we were talking about that, we'd see a definite rise in people who use independent distribution in this listing.

I wanted to say something else. We don't show it here, but the VL market is still less concentrated than the VA market currently. We know the VA market has gone through quite a bit over the past three or four years in terms of consolidation and people getting out. One might believe that there is some potential for further consolidation.

What are the key factors driving the VL market share? Accumulation sales are driven heavily by equity performance, hence the decline, hence the small increase in 2004 with strong equity market performance over 2003. Interestingly enough, single-premium VL is still not performing up to its sales expectations. It's a versatile product, and there were some strong expectations in the late 1990s as to how sales would take off. They haven't. One thing that we feel is hurting is the complexity of the product. VL has a lot of moving parts to it, and if you want to sell it in a purely investment context, it's easy for the nontraditional distributors to not fully appreciate the many mechanics of the VL, and so they move to something else.

As far as protection VL goes, we know it's been hurt by the no-lapse-guarantee UL, where we see VL is unable to match the prices for no-lapse guarantees on fixed UL policies.



Let me go through my distribution trend slide (Hareman slide 9). It compares 2000 and 2004. The general trend is career is receding somewhat relative to the other channels. I don't want to dwell on that too much. Distribution seems to be a major challenge for most people, as was borne out in Christine's slides. The career channel is still the primary channel. Career agents are still declining. That's a challenge for VL, and now we've seen that stockbroker and bank sales have not materialized. Again, we think a big part of that is the complexity of the product. We know that sales through banks, in particular, are heavily focused on simple products and simple process, and VL doesn't fit into that too well.

Regarding issues and trends, take a look at the evolution of VL. There have been some changes over the past four or five years. We're seeing a decline in COIs. We know that reinsurance is widely used for the mortality component of VL, and it's typically 90 percent YRT. We think that the aggressive posture or mortality by summary insurers has allowed carriers to lower their COIs and pass those things on. Interestingly, we expect that this will slow going forward, given the consolidation of the reinsurance market and the gradual shift in reinsurance views of mortality, particularly mortality improvement.

The second big thing is that on the M&E side, most products now incorporate the so-called stepdown to improve illustration values. Typically after 10 years or so, you'll see the M&E drop to a fairly low level, 10 to 20 basis points. It improves illustrative values, and what companies have been doing, oddly enough, is typically putting load that they would have gotten from M&E into COIs. We want to keep the probability up; we moved the load structure around a bit.

The other interesting thing I found was that the front-end fees and surrender charge have not changed a lot over the past five years, which suggests that there has definitely not been strong price pressure on those from the consumer point of view because these are things that the consumer sees. These are things that the consumer sees more easily, and we haven't seen downward pressure on those fees at all.

Another comment that comes back to something that Christine said is about five years ago there was a bit of a battle between fund complexes. Were we going to offer single-fund manager or multiple-fund manager? All products now offer multiple-fund complexes, so fund selection is not the differentiator that it was seven or eight years ago. I have one more point on that. I would point out that what we do see is that carriers with large VA operations are often able to get better deals from their fund managers, which is not surprising.

In addition to the changes in charges, I've got a couple new design elements to talk about briefly here. You've seen the birth of alternative death benefit options expanded from the basic two option A and option B death benefits that we've seen. We've also seen the birth of GLBs on VUL policies and the so-called surrender squeeze solutions.

We've seen two new benefit options being offered by companies in addition to the standards. The first is the return of premium option. What that is doing is essentially what it says it's doing. We are essentially guaranteeing a return of premium plus a specified amount on that with the appropriate adjustments. This has become popular with some carriers, and it's interesting to see how these things are going to take off. It's become widespread, but we don't have a good feel necessarily as to how the take-up rate of this particular option is relative to others.

We also have the return of investment account, which essentially returns the separate account value, plus the specified amount. This is all in an attempt to give the consumers more choice, more control of the product and more options.

We've also got the guaranteed withdrawal benefits of the period on VL. Only only a few carriers currently offer them that I'm aware of, but we know that there is a bit of buzz around this out there. Others have expressed interest, and we know about two carriers that are seriously looking into adding these to their products. Again, this is more of a play on the accumulation space, I think, and also to some degree the income space that Christine was mentioning. They're competitive with the VA product features. Typically what the companies have done is take their existing GLBs on their VA products and add it on to their VUL products. These are all pretty new. We don't have a good sense as to how well the take-up rates are going on these. It would be interesting to find out from people in the audience whether they're offering them and what they are seeing. It came from an asset-based charge, which is interesting, given the nature of VL. That is a fascinating second development.

The third thing that's going on is the so-called surrender squeeze prevention rider, and most of you should be familiar with the surrender squeeze where typically you set up loan provisions in your VUL and borrow against the fund value, intending to use that as income. If timed correctly, you die, and the loan is repaid with the death benefit if anything is left over. That's a way of getting money out of your VL policy and using it as income, which is something again that Christine brought up in her description. The problem is that if you live too long, you reach a point where you are unable to support the loan, and at the same time you've got a "damned if you do, damned if you don't" thing. You either pay a huge premium to keep the policy in force or lapse the policy and suffer a tremendous tax disadvantage.

What these riders are intended to do is to prevent this from happening by allowing the policyholder to give up certain controls when a policy reaches a certain point in exchange for guaranteed coverage for the remainder of the lifetime. It's essentially a bit of a no-lapse guarantee where the policy will not lapse. At the same time, it is costly in that there are a lot of conditions around these riders, and you can no longer take further withdrawals. You can no longer take loans. You're locking in the amount you're getting as your death benefit, and the election is irrevocable.

There's also a one-time charge at election, which varies tremendously depending at which point you are in the policy, meaning your age at the time of election and so on. It's an admirable attempt to address a problem that we have seen with these and with the way they were being used, but it's also extremely complex, requiring quite a bit of explanation to the policyholder and quite a bit of calculation at the back end. There's some concern that people may not understand fully what they're getting into if they elect this. It'll be interesting to see how it plays out. They're new, so I'm not aware of anybody having experienced any elections even though there have been some people who have taken them up.

There are some concerns about that, but it'll be interesting to see how it plays itself out. I'd be interested to hear from anybody who is working with these or whose company has them and what their discussions are internally.

I'm going to talk about VUL without talking about 2001 CSO. It's coming. You have been hearing about that for a long time now, so everybody knows about it, backward and forward, but would I would be remiss if I didn't mention the effect it's going to have on the VL. Obviously it's going to have a bit of an adapting effect on accumulation. We've estimated reduction in guideline premiums of 10 percent to 20 percent, varied by age and risk class. That will limit the product's effectiveness as an accumulation tool. Also we're going to limit the matching COIs now, so we're going to run into a situation where perhaps we'll not be able to lower COIs as much as we were doing in the past. We'll have to find other places to put these margins, which for some is a crying shame because COIs are opaque to the policyholder, whereas a lot of other margins are not.

Outside of that, companies will need to refresh the VL portfolios. Obviously, there's the school of thought of putting it off as long as possible, but it's something that we know is coming, and by 2009 everything must be fully compliant.

I want to talk about the future outlook, which may be a little different from some of what Christine was saying, but basically our position is there is a little glimmer of hope in the sales rebound. Equity markets have grown over the past two years, albeit not as much in 2004 as in 2003. We would expect that sales growth in 2005 will be flat or slightly positive based on the status quo projection of what we're seeing and what we think drives the bulk of the sales.

What we're seeing is that the products appear to be increasing in complexity, which is funny when you think about what Christine said about wanting to make the product simple from a distribution standpoint. Increasing complexity with these riders is going to make it harder for the nontraditional insurance distribution to get a hold on these products effectively because compliance requirements are also going to increase with complexity. The market clearly has gone more to accumulation. There are still some sales of UL out there. Christine, I don't know whether you mentioned the LIMRA study, which shows that people are attempting to use protection as a sales tactic, but with UL guarantees the way they are and have been, it's hard to justify protection only to VUL sales. We would point out that if these guarantees lose luster and prices go up, you may see the protection VUL make a comeback.

MS. FRIEDMAN: We have plenty of time for questions.

MR. MARTY KLINE: You say that the VUL market has gone to more accumulation, and that's a response to UL secondary guarantees. Do you mean a percentage of VUL sales are going more toward the accumulation versus the lower cost, or is that in general reflective of the entire VUL market?

MR. HAREWOOD: Statistically we're talking about percentage.

MR. KLINE: I understood that the greatest value of VUL is accumulation, but is there something else I'm missing?

MR. HAREWOOD: No, but to go back a bit, we can talk about individual VUL, not survivor or single premium per se. We can think of the individual VUL sales as being either an accumulation or protection-oriented sale. In the accumulation-oriented sale, we want to sock as much money as we can in there and enjoy the tax rebuildup and exposure to equities, but generally we try to accumulate a large fund. In the protection sale we're trying to pay as little as possible and hope that large equity earnings will allow that small amount to be sufficient to cover permanent protection.

Accumulation has always been the more dominant of the two. We see that with the birth of what some will call reasonably priced UL secondary guarantees (others will not call them reasonably priced). If people want permanent protection at the lowest possible price, their best bet is probably to get a fixed UL with a secondary guarantee rather than a VUL policy. What we're seeing is that the premium dollars are much more focused on accumulation than a protection.

MR. DAVID WEINSIER: I have a question for Rhonda. At AmerUs, when determining the appropriate notional amount to hedge, how you adjust the premium that comes in two decrements, such as persistency and mortality? Even if you offer a fixed as well as an indexed account and allow transfers, I imagine you'd have to take those transfers to the fixed account into consideration, as well, and that would almost count as a decrement and would impact your hedge. I'm interested in how you would adjust your notional amount for those potential changes in your equity-indexed component.

MS. ELMING: That's a good question and something I didn't touch on in the presentation. Every company is going to have to make a decision regarding what percentage of the premiums going into the indexed strategy is going to be hedged. At my company, we've taken a conservative approach, and we hedge 100 percent of the premiums that go into the indexed strategies. Other companies have a different approach and reduce the premiums by a factor to account for expected lapses and expected deaths.

FROM THE AUDIENCE: What about the transfers?

MS. ELMING: At our company, we don't allow transfers between funds, so we don't make an adjustment for that, but I'm sure that if we had that provision, that is something that would have to be taken into consideration.

That's one of those issues where a simple product design might be better. It offers something structured, similar to what the gentleman mentioned would offer flexibility for the policyholder, but it will be easier to administer.

MR. SCOTT RUSSELL: What kind of caps, range of caps and participation rates are you're seeing in the marketplace for the equity-indexed UL?

MS. ELMING: It varies. The products that we offer have a cap that varies based on indexed crediting strategy. I've seen caps of 12 percent for annual reset strategies and caps as high as 30 percent for two-year point-to-point strategies. There's quite a range, and again it varies based on the strategy. At our company we have the 100 percent participation rate, but there are other companies that have a 50 percent to 60 percent participation rate and then don't have any cap on the earnings. It depends on how they've designed their indexed crediting strategies.

UNIDENTIFIED SPEAKER: Given all the potential litigation problems equity-indexed annuities could produce in the future, I think a lot of people are scared about whether the consumer understands the credited rate mechanism on the indices. Is that something on indexed UL that you've thought about as a direct writer and have put forth action in place to get more specific warnings to the policyholder?

MS. ELMING: Understanding the indexed crediting mechanism in the indexed life products is extremely important. We want those agents to understand how it works so that they can present it to their clients appropriately, and we want the clients to understand how it works. We have taken a lot of steps to ensure that we get that communication out. We have a lot of language in our illustrations, which buyers are required to sign. We have consumer brochures, as well as agent product guides, that emphasize how the indexed crediting strategies work. We also have a piece that we send out with every policy that we issue called "Understanding Indexed Life Products," and it goes into a discussion of how indexed crediting strategies work and how these products are different from traditional fixed products. It is important to make sure that people understand what they're buying and that expectations are set appropriately because if the consumers' expectations aren't met a few years down the road, that's when you have a market conduct or litigation potential. Another differentiation between indexed life and indexed annuities is target market. We are targeting the baby boomer generation. On the indexed annuity side, I believe that the average issue age is a lot higher than the average issue age on the life side, and so they may have some unique considerations there.