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UNIVERSAL LIFE

WHO CONCEIVED THIS INSTRUMENT?

Subject to responsibility being accepted (and documented) by somebody else, we hold that the father is George R. Dinney, and the place of conception Winnipeg, Canada. In response to our enquiry, Mr. Dinney recounts the history thus:

"John Galsworthy said that the beginnings and endings of human undertakings are untidy. I do not recall the exact moment when I first shouted 'eureka', but it most certainly was in the period 1962-63. This conceptive 'eureka' has been followed by other cries of 'eureka palin' (I have found it again) and, belatedly, by a simple, and at times congratulatory 'eurekas' (You have found it).

"In 1962 I was engaged in developing and promoting new Group insurance products. The Universal Life Plan was conceived as an improved Group Permanent plan. The product name, i.e., with Group preceding the other three words, served two purposes. It evidenced my predilection for generic solutions; it also permitted expressing the fundamental characteristic in a simple slogan; 'Make your life insurance problems disappear with one GULP!'."

WHO BROUGHT IT INTO THE INSURANCE WORLD?

Quoting further from Mr. Dinney's answer to our letter:

"In the mid-1960's I explained the plan to Thomas P. Bowles. In 1975 Mr. Bowles' associate, James C. H. Anderson, made a singular contribution to the technical development of modular product in his paper, 'The Universal Life Insurance Policy,' to the 7th Pacific Insurance Conference in California."

IS UNIVERSAL LIFE HERE TO STAY?

by John F. Fritz

Ed. Note: This essay came from Mr. Fritz at the invitation of the Society's Committee on Continuing Education, of which he is a member.

The question that forms my title has often been asked since the first Universal Life product was introduced in 1979 by Life Insurance Company of California, now E. F. Hutton Life. I believe it's good for policyholders, is good for the industry, is here to stay, and will be a major force in life insurance future.

Since 1979, about 25 companies, including some of the larger ones, have entered the market place with a similar product. That number may increase to 100 or more by 1982.

Yet, the product's future rests in regulators' hands. The entity that will have greatest impact within the U.S.A. is the Internal Revenue Service. State insurance department decisions also will be influential. Will the consumer triumph? Here are three of the major questions.

Policyholder Federal Income Tax

In January 1981 the IRS issued a private letter ruling on issues affecting taxability of E. F. Hutton Life's product.

Are death benefits (including the cash value) life insurance proceeds as defined by IRS Code Sec. 101 (a)(1), and thus excludable from the beneficiary's gross income? Are death benefits payable under two term riders attached to the policy likewise excludable? Will there be no constructive receipt by the insured of the inside build-up of cash value, and hence no income tax incurred unless cash values withdrawn exceed premium payments?

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OUR PRODUCTS DO MEET PEOPLE'S NEEDS

by Ian M. Rolland

Ed. Note: This is taken from Mr. Rolland's remarks at LIMRA's 1980 Annual Meeting.

Life insurance products are far from static—they evolve to suit the markets they serve and the public's needs. Companies who look ahead and whose product development cycles are suitably short will keep abreast of change and still yield a reasonable return on shareholders' capital. Thus our industry confirms its role as handmaiden to economic needs.

A new generation of permanent life insurance products not only answers criticism directed at whole life plans but also stands apart as uniquely attractive financial products. Among these are: (1) *New Participating products* with variable premiums, and dividends designed for cost effectiveness in specific markets; (2) *Flexible premium non-par policies*—necessary for stock companies to compete in long-term net cost with participating policies in these economic times; (3) *Variable Life*, an early Seventies innovation now being reintroduced with new funding vehicles and other variations that will make it interesting to watch as an inflation-fighting product; (4) *Adjustable Life*, ultimate in flexibility though its administrative complexities challenge even sophisticated data-processing systems, and specially well suited to the pension trust market; and (5) the "Universal Life" concept, dividing the whole life contract into term insurance and investment elements, giving choice of face amount and premium, and permitting the buyer's term premium to be paid out of the investment fund, which accumulates at current interest rates.

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Here To Stay?

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On the first of these, the IRS ruled that such death benefits are to be treated as life insurance proceeds, but cautioned that the cash value must be "equivalent to the cash value or reserve under a more traditional life insurance policy" and not be a "side fund" variety of cash value. The second ruling conceded that term riders too are life insurance proceeds under the section cited. And on the third question, the IRS concluded that the policyholder would not be in constructive receipt of credited interest prior to surrender. Although presumably indicative of the Service's general feelings, a private letter ruling is directed only to the taxpayer requesting it, and may not be used by others or cited as a precedent.

Company Federal Income Tax

There have been no official IRS pronouncements on treatment of Universal Life for company tax, the major question being how excess interest credited to reserves and cash values is to be handled. A consortium of life companies happens just now to be seeking IRS's answer to this excess interest question for annuity contracts; that emerging ruling should indicate the rule that will apply to Universal Life and other products that involve life contingencies. Meanwhile, at least one company has requested a ruling on this point.

State Insurance Departments

In general, state regulators are displaying willingness to accept innovative products that benefit the public. Universal life has, though, encountered difficulties in seven states. And many department approvals are subject to close subsequent monitoring related to company solvency, disclosure to prospects and policyholders, and compliance with valuation and non-forfeiture statutes.

Because of this product's flexibility, tables of non-forfeiture values in the policy aren't much help. Nevertheless, some departments do require them. Since premiums, cost of insurance rates and interest credits all vary, the best and usual arrangement is to furnish nonforfeiture value specifics to policyholders annually. Making the calculations retrospectively, the product can be shown to be in compliance with current valuation and non-forfeiture laws.

As to solvency, insurance departments are most worried about products that tie the interest rate to an outside index such as, to mention one example, the 91-Day U.S. Treasury Bill Discount Rate. Their main concern is whether investments underlying such a promise will satisfactorily match the index in both size and period to maturity. Proper matching can be demonstrated by earmarking the assets that support the reserves—either by earmarking specific assets in the company's General Account or by forming a separate company to write only Universal Life Products.

The Challenge Ahead

The challenge our industry faces was brought on by outside economic and social forces. Erosion of savings dollars, moves into term insurance, replacements, high lapses . . . all are reactions to external influences. If we are to avoid the loss of our share of public savings, we must change. Our traditional products perplex people and lack flexibility. Rates of return are hidden in language and arithmetic that only actuaries understand. We must show competitive results in ways that non-insurance people can measure against other savings forms.

Some charge that Universal Life is a "replacement product." But replacements isn't new; it has been with us and will remain with us, whether or not Universal Life survives. It would be less of an issue if our policies on the books met today's demands. The issue must be, "What is best for the consumer?".

Companies with large blocks of traditional permanent life insurance in force must address the replacement issue in terms not only of other companies but also of their own field force. Should a company openly replace its own business? The answer depends on the specific circumstances. If a company isn't willing to replace its own business, won't it be replaced by somebody else?

Clearly, unresolved issues surround Universal Life. Its present form may or may not be the ultimate solution, but it is a step in the right direction. □

"UNIVERSAL LIFE: THE REGULATORY DILEMMA"

This is the title of a paper written and circulated, specially to regulatory authorities, by Douglas L. Paine, and doubtless obtainable from the author at his Year Book address.

It says that the Universal or Open Life Policy concept may very well represent a turning point for the insurance industry and that the future may see proliferation of such policies.

This paper offers suggestions on nonforfeiture calculations, cost indexes, policy projections (illustrations) and valuation considerations.

Products Do Meet Needs

(*Continued*)

Today's products do meet people's needs—and will change as those needs change.

Ed. Note: For a distinctly different viewpoint, see "Why Universal Life Is Not The Solution," PROBE, Vol. 28, No. 13, July 1, 1981. Says Probe Editor John L. Lobingier, Jr.:

> "The big question is whether or not the mainstream of life companies will succumb to the current euphoria and bring universal life-type products to market. It would be a mistake for the business to do so, in my view. There are dangers to the universal life approach. There have to be other products and combinations of products that will avoid those dangers and prove to be superior to universal life over the long run—both for companies and for consumers." □

RISK FROM INTEREST RATE SWINGS TO BE DISCUSSED AT ATLANTA

by Carl R. Ohman, Chairman, "C_3 Risk" Task Force

In these hectic times, any actuary who certifies that annual statement reserves make good and sufficient provision for unmatured obligations must take into account the risk of loss from changes in prevailing interest rates. This risk—immediately apparent in Universal Life contracts—was given the symbol C_3 by C. L. Trowbridge's Committee (*Record*, Vol. 5, No. 1, p. 261) in April 1979.

Our Task Force plans to introduce its first report for discussion at the Society's Atlanta meeting on October 20. Our second, final, report will be presented at the Houston meeting in April 1982. The research now underway is expected to prompt extensive subsequent debate and research. □