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The Nonqualified Plan Market

by Sara K. Miller

A pall has been spreading over the most affluent prospective retirees as they realize the depths of the cuts that Congress has imposed on qualified plans—particularly for the most highly paid. The cuts are real and hurt most for those at the top end of the compensation scale.

Typically a defined benefit pension plan will provide a certain portion of the employees' average salary for the final five years of employment. Often the executive will remember that but will forget the details that take the glitter out of that shining dollar amount. First, very often for executives of that level, a significant portion of their income is in the form of bonuses, not traditional salary, and most often bonuses and other extra compensation don't count when figuring what the final pension payout will be. But that bonus compensation, or rather the loss of it, may not matter anyway since there is a ceiling currently at $90,000 on the amount that can be paid out, and this normally makes the final payout a much smaller percentage of final compensation than expected. There are also other hindrances. A surtax is now placed on qualified plan payouts if the total annual amount the retiree receives is above $200,000. 401(k) plans have been further limited. And as a last straw in order to protect the income for a spouse, the retiree may need to elect a joint and survivor payout from the qualified plan.

When all of these limitations are put together, it is not at all uncommon to find the real payout to be less than half of what the executive expected. Since these cuts have caused such a gap between the retirement income not just desired but expected, there is now a tremendously expanded market for nonqualified plans. At Northwestern Mutual Life (NML) we have been developing plans to help our field capitalize on that market opportunity.

Initially we identified five separate tasks or areas of work and attacked each separately. First, the market had to be identified. Just who are the prospects? We know that a classical definition is that a prospect must be a stable ongoing corporation that has a willingness and desire to benefit top management and that it must have the cash flow to sustain such a program. We also know that the market is not necessarily limited to large public corporations but spans the whole range of sizes and types of businesses. Corporations love these kinds of plans. Where else are they not only allowed, but actually encouraged, to discriminate? In order to keep the plans out of the clutches of most of the ERISA rules, the plans must be for the benefit of the most highly paid employees of the company. Further, the corporation does not have to put up its own money. The plan may be designed as a deferred compensation plan wherein the employee defers his or her own money, and the employer acts as a conduit. Many times, even though the employer was unwilling to put up the initial money for the funding of the plan, it will fund the benefits out of current cash and recover its cash outflow plus interest from the death benefits of the policy.

The next job is to educate the field. We have done the traditional video tapes, articles and seminars talking about the market, the products, the tax laws, and the opportunities. While there are certainly a finite number of Fortune 100 companies, many good agents find their niche with smaller companies. While the corporation may be smaller and the number of lives sold only five to ten, the premium dollars may be large and the persistency excellent.

The third area of work was to provide properly designed products. Up until this time, the agents who had been working in this market had been successful using the same products that were utilized in the individual market. Now, we began looking at this market as one that had particular needs that could be satisfied with specific product design. Many times we were finding that some agents were producing very well using the traditional individual products, but the needs and the competitive nature of the sales of others demanded more specialized products. To satisfy that need we are now ready to release the third product that is designed just with this market in mind.

The fourth area of responsibility was to provide appropriate Home Office service and support. Four departments have now put together separate groups of people dedicated to responding to this market. The first department to do this was Individual Product Marketing. Within this department an executive benefit unit was formed. This is a small group of four people who spend their time working with agents who are developing cases in this area. This unit helps provide plan designs and accompanying illustrations that are far more sophisticated and individually tailored than those that are available through the standard NML illustration system. Many field associates utilize this unit for case consultation and for illustrations, but more importantly, the people in this unit serve as a sounding board for the agents who don't have anybody knowledgeable to talk over their ideas with, thus facilitating the sharing of information across the country. The idea that helped make a sale in Sacramento may be just what the agent in Buffalo needs to help him finish putting together his presentation. This unit is then familiar with today's marketplace and serves as a liaison with other parts of the company relative to matters concerning executive benefit cases. The unit relates product needs to the actuarial department; documents needed improvements in willing and collecting methods for multilife cases; serves as an on-site representative in matters concerning new business; and knows first-hand exactly what areas need to be concentrated on in future training sessions.

For several years one senior individual has been responsible for coordinating all of the executive benefit guidelines and procedures in new business. He, too, can act as a liaison person with the rest of the company regarding executive benefits cases. The field people really appreciate having one person to go to, if necessary, as a last resort if they feel that they have a special case and a valid reason for needing extraordinary treatment. Policyowner Services has just put together a separate unit of eighteen people who will deal only with this marketplace. Billing and collecting premiums for cases like this, always one of the problem areas, is being attacked first. Again we believe that a great dissatisfaction can be removed when the agent with a problem has someone in the appropriate area to talk with who understands what is

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Market Cont'd.

going wrong and has some idea of how it can be fixed. The actuarial department also has dedicated specific resources to working on products and improvements on products for this market.

The last area to be addressed in this market is the need for the agent to do the appropriate servicing at his end. If there is anything we all do know, it is that servicing of the products in these plans and the servicing of the plans themselves are not inexpensive things for the agent to do. We certainly don't know where ultimately the funds will come from to pay for this servicing. Some of it will come as it traditionally does from commissions; some may come from fees. But we are sure that the agent who is able to do this work as efficiently as possible will have a large advantage. Part of this efficiency comes through enhanced home office policy servicing systems; but much of it must come from the agent himself, or his designated representative. Ultimately, that servicing entity must have a system within his own four walls to keep track of all of the plan data and the policy data. That is the last piece to be put into place.

Northwestern Mutual is excited about this market. It has great potential, and it's a lot of fun to sort out the pieces, put them in place, and hear the satisfaction from the agents as they increase their sales.

Sara K. Miller, not a member of the Society, is a J.D., CLU and FLMI. She is Director of Advanced Markets Support at Northwestern Mutual Life in charge of that company's Executive Benefit Marketing Operation.

TSA Papers Accepted

Four more papers have been recently accepted for publication in the *Transactions*, Volume 40. The papers are:

James D. Broffitt, "Increasing and Increasing Convex Bayesian Graduation"

Mark D. J. Evans, "Amortizing Acquisition Expenses in Proportion to Premium Revenues"

Thomas N. Herzog, "Analyzing Recent Experience on FHA Investor Loans"

Harry H. Panjer, "AIDS: Survival Analysis of Persons Testing HIV+"

Variable Products— Today's Design Trends

by Timothy C. Pfeifer

New variable life and annuity products have been growing in prominence in the portfolios of many life insurers. Today's products have evolved from the original forms issued in the late 1970s and early 1980s. SEC and state insurance department regulation, as well as increasing consumer sophistication and competition, have shaped the design of these products. We'll examine some of the recent trends in the design features of variable products. Nearly all newly-developed variable life contracts are either flexible premium variable universal life (VUL) or single premium variable life (SPVLI), as opposed to annual fixed premium variable life (VL). Past SEC regulations effectively prohibited premium flexibility on variable life contracts paying typical whole life commissions. In 1983, temporary rule 6e-3(T) enabled VUL designs. Since then, fixed premium VL product development has sharply declined in favor of VUL. Today's variable product designs frequently resemble those of mutual funds. Recent variable annuities and variable life products have moved to back-end load (surrender charge) and asset fee designs. The shift to back-end load products is largely a response to competitive market conditions. In addition, variable products are sold through distribution channels, such as stockbrokers, that are accustomed to selling back-end loaded products.

Single premium variable annuities (SPVA) and single premium variable life products have recently dominated the variable marketplace. This year, some insurers have delayed development of a VUL product until their single premium variable life was completed. Reasons for this current popularity include:

- SPVLI's and SPVA's current tax-sheltered advantages cause them to be more attractive than many other deposit institution products;
- "Fire sale" marketing approaches are being used, since these tax advantages may be short-lived;
- Certain single premium products can be easier to administer;
- Maturing certificates of deposit, which could only be reinvested at low current interest rates, have been sources for premiums in many single premium variable contracts.

Many current SPVLI product designs permit the policyholder to pay additional premiums under certain conditions. This flexibility offers competitive advantages to the insurer. Another reason for permitting additional premiums is that the contract may qualify as a flexible premium contract. A flexible premium life contract can deduct higher maximum annual mortality and expense risk charges (deductions for mortality and expense guarantees) of .90% of the fund versus .60% for fixed premium plans. It appears that the SEC will consider a SPVLI contract to be a flexible premium contract if the policyholder has the contractual right to pay an initial premium as low as 80% of the guideline single premium. Legal counsel familiar with SEC issues should be involved in designing these features.

The foundations of VUL, SPVLI and variable annuity contracts are the individual funds which determine the policyholder's cash values and death benefits. Insurers continue to diversify the types of available funds. Beyond the typical money market, stock, bond, general and managed accounts, separate accounts now include high yield bonds, aggressive growth stock, gold, zero coupon bonds (of different maturities), real estate, and international funds. We expect this expansion to continue as insurers try to market at least one "hot" fund at any time.

Variable annuities and variable life contracts permit transfers of monies between funds. The trend is toward an unlimited number of transfers without transaction charges. Sometimes, the first few transfers are free, and any additional transfers are levied a charge of $10 to $25. Actual experience so far has shown little transfer activity. At the time of this

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