Article from:

The Actuary

September 1997 – volume 31 - Issue 7

EIPs explained

As insurers continue to seek new products, actuaries will take an active role in developing them. Here, two actuaries discuss an innovative product group — equity-indexed products — that is selling well but has raised some questions among regulators. In addition to describing equity-indexed products, the authors talk about actuaries' involvement in efforts to address some of the issues. The authors welcome comments and questions from readers of The Actuary.

The cure for our savings problem?

by Richard D. Farrell

"Save for a rainy day." Although many have received this advice, it seems most individuals do poorly when it comes to saving money.

A recent study by Fidelity Investments revealed half of all working Americans ages 22-61 have less than $10,000 saved toward retirement. An April 1997 survey by Scudder, Stevens & Clark, Inc., showed that among the 1,140 Baby Boomers surveyed, one-fifth had less than $10,000 and two-thirds less than $50,000 in their 401(k) plans. It seems that most Americans are not taking the steps needed to provide for a comfortable retirement. By saving too little and waiting too long to become serious about investing, many baby boomers will need investments with relatively high rates of return to achieve their retirement goals. Historically, such returns have come only from equity-based vehicles.

According to the Variable Annuity Research and Data Service, Atlanta, one-third of variable annuity assets were allocated to general account and money market accounts as of March 31, 1997. This is an indication that large numbers of individuals allocate a high proportion of their assets to low-yielding vehicles. Often, this stems from the fear of possible loss of principal, investment advisors say. Those using an overly conservative strategy risk inadequate rates of return.

There are also potential problems for current equity investors. Many have

little experience with equities and have not experienced a bear market (a drop in stock prices of 20% or more) because of the favorable run enjoyed by the stock market since the early 1980s. If such investors "run for cover" after a bear market, adopting an overly conservative attitude and strategy, they also risk too-low rates of return on their investments.

Are EIPs the answer?

Equity-indexed products (EIPs) are well positioned to help address the savings problem. Although there are many variations in EIP design, the basic premise is for the cash surrender value to vary according to a formula which is driven by a predefined equity index (e.g., the S&P 500). Unlike variable products, EIPs provide minimum guarantees of the cash surrender value that typically meet or slightly exceed those required by nonforfeiture laws. EIPs are usually supported by general account assets and

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Still evolving, hot product group gets actuaries' scrutiny

by Donna R. Claire

Equity-indexed products are hot in the marketplace today. More than $1 billion in equity-indexed products (EIPs) were sold in 1996, and estimates for 1997 range from $2 billion to $10 billion, according to many investment bankers involved with EIPs.

As EIPs have taken off in the U.S. insurance market, so have regulatory concerns about appropriate disclosure and reserving. These concerns were expressed at NAIC meetings, with some states either shutting down the approval of the products (including revoking earlier approvals) or suggesting they might do so unless reasonable methods of regulating EIPs could be developed. Several initiatives by actuaries aim to resolve issues and concerns that have led to a "go slow" attitude among many regulators.

Actuaries taking active roles

At the request of the NAIC, the American Academy of Actuaries formed the Equity-Indexed Products Task Force in January 1997. The task force has issued three preliminary reports, the most recent in August. The group is charged with producing a final report, expected by the end of the year, that will:

- Address the many issues surrounding equity-indexed products

The experiment was a success in terms of favorable placement. When searching for a “life insurance actuary,” the member’s Web site ranked first in 2.8 million hits using Infoseek and first in 1.5 million hits using AltaVista.

TABS has secured favorable placement of other pages on the major search engines using various keywords, sometimes occupying more than one key position. For example, when searching for a “pension actuary” on AltaVista, TABS sites rank first, second, third, fourth, sixth, and seventh. (Our pages are the ones that start with *www.virtualbenefits.com*.)

Of course, not everyone can be first in every category. This is why it’s so important to register with all the major search engines and to compile an extensive list of keywords and phrases that prospective clients are likely to use when searching for the services you offer. Then, if you don’t place well on one search engine for a particular keyword, you have a good chance of placing higher for a different keyword or for the same keyword on a different search engine.

But does all this actually result in new business? Well, our experimental subject obtained his first major assignment through his AltaVista and Infoseek placements within two weeks after taking their number-one spots.

Other ways to get noticed

Getting to the top of search lists isn’t the only way to get noticed on the Web. Another way is to cross link your Web site to other sites. For example, if you do life insurance company valuation work, you might get a casualty or pension actuary to provide a link to your site if you do the same for them. Or, better yet, cross link with non-actuarial firms that deal with companies who might need your firm’s services. Some examples might be an accounting firm or a communications consultant.

There are also companies who will help you establish cross links free of charge. These firms make money by providing more extensive advertising to some companies for an additional fee. One of the most popular of these is LinkExchange (*www.linkexchange.com*). Another way to publicize your site is to include your Web address on all company materials such as stationery, business cards, and newsletters.

You can get your name on the Web even if you don’t have a Web site. One way is to register with several of the many online “yellow pages.” Some are free and some charge a small fee. Libraries and book stores carry Web site directories, which provide information about online yellow pages. Or — you might go to a search engine and key in “yellow pages.”

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are not considered to be subject to rules governing securities.

Most EIPs provide at least a return of principal along with guaranteed interest credits so long as the contract is not prematurely surrendered — and even if there is a “total meltdown” of the stock market. Furthermore, excess interest might also be payable in such a disaster scenario depending on the product design and the stock market’s path. These features increase the likelihood that EIP owners will “hang in there” during a bear market.

As with any retirement savings product, EIPs can help address the savings problem by diverting money away from current consumption. With interest credits based on performance of an equity index, these products also have the potential to deliver the higher rates of return which will be needed. Meanwhile, EIPs may be acceptable to many conservative individuals because of the guaranteed principal feature.

Many EIPs can only be surrendered without penalty during brief window periods that open only once every 5-10 years. This relative lack of liquidity can be viewed as consumer friendly because it provides an incentive to stand firm when the market hits a scary bump in the road.

If an EIP owner takes no action while the window is open, the EIP mechanics simply kick in again until the next window. This feature also can benefit the consumer. If the process to “re-enroll” was more cumbersome, hesitant or indecisive consumers might return their savings to conservative vehicles.

Actuaries have made many valuable contributions to the evolution of EIPs including product development and addressing issues related to pricing, reserving, and investing to make EIPs profitable for both their issuers and consumers. In Dave Holland’s presidential address at last year’s SOA annual meeting, he stated, “Actuaries provide service to the public by developing and valuing financial programs.” EIPs represent one such program. Members of our profession should continue to seek innovative approaches to finance — especially when such approaches have the potential to address social problems.

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