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PRODUCT INNOVATION—RESPONSE TO CONSUMER NEEDS IN THE 1980'S

*Moderator: CHARLES W. McMAHON. Panelists: BARRY L. BLAZER, ALAN RICHARDS, WALTER H. ZULTOWSKI, Ph.D.**

1. Consumer Concerns, Needs and Desires in the 1980's

   a. What will the consumer require in life insurance protection and savings?
   b. How will his perception of his needs and concerns differ from those of today's consumer?

2. Products to fit these requirements

   a. Flexible Products
   b. Possibility of Insuring Against Other Contingencies Which Adversely Affect Income (Example: loss of job or divorce).
   c. Product Ideas from Other Countries.
   d. Keeping Old Products/Policies up to date.
   e. Group or Individual
   f. New products which may be invented in the 1980's.

MR. CHARLES W. MCMAHON: One of the challenges of this convention is to consider what the life insurance industry can do to influence the course of events in the 1980's. In other words, how can we act rather than react? Our panel today is prepared to venture into this future with some imagination, daring and innovation and perhaps some controversy.

DR. WALTER ZULTOWSKI: One of the nicest things about being asked to give this presentation was that it forced me to organize my thoughts about the financial needs and concerns of the consumer in the upcoming decade. In preparing this talk, however, I found myself constantly nagged by two problems, the first was the feeling that I was beating the proverbial "dead horse." I suspect that many of you had your fill of talks on the eighties long before the eighties even began. Even if you have not, I am sure that you have given some thought as to consumer needs and concerns in the eighties - if not because of the nature of your work, than because of the simple fact that we all will be (and actually already are) consumers in the 1980's.

The bigger problem I had, however, was trying to decide on the economic and social environment that the American consumer will be facing in the eighties. At LIMRA we have been conducting surveys of agents, policyowners, and the U.S. public in general since the early 1920's, and this research provides us with a tremendous source of empirical information on the financial needs and concerns of the American consumer. Our research generally indicates that the public can be best described as conservative and risk aversive when it comes to financial matters, but perhaps the most remarkable finding has been the stability of the public's financial needs and concerns over the years. This really is not surprising, though, be-

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cause when you are dealing with financial needs and concerns, you are really dealing with basic human needs for security, protection of one's family, and general well-being.

The point I want to make, however, is that based on the stability of our past research findings, I could have stood here 10, 20, or 30 years ago and very confidently discussed financial needs and concerns in the 50's, 60's, or 70's. As I stand here today, though, I am much less confident of my description of consumer needs and concerns in the eighties. We really do not know, for example, what consumer reaction would be to a prolonged period of high inflation and high interest rates. The eighties might provide us with a decade the likes of which we have never witnessed, and if so, consumer behavior and attitudes may be much less predictable than in the past.

So, at the risk of covering some issues that you have already thought about, and at the risk of making some statements that may prove very amusing in the years to come, let me review what seems to be some of the major financial needs, concerns, and desires of the American consumer in the 1980's.

Let me begin by saying that, by far and away, the predominant financial concern of consumers in the eighties will be financial security. I base this belief on two factors. First, social science tells us that the best predictors of future attitudes and behavior are past attitudes and past behavior. As I have already mentioned, we have been conducting consumer research at LIMRA since the 1920's, and one of the primary focuses of our consumer research has always been the extent of life insurance ownership among the United States public along with the public's reasons for buying and owning life insurance.

What we find is that the public clearly recognizes the need for life insurance. Our most recent survey of life insurance ownership was conducted at the end of 1976. At that time there were 73.9 Million households in the United States. In 83 percent of these at least one member of the household was protected by some form of life insurance, and in 55 percent all household members were insured. Among husband-wife families with children under 18 years old, on the other hand, 93 percent had at least one insured member of the family, and in 91 percent of these families there was some form of insurance on the life of the husband. Moreover, whenever we have asked consumers why they buy and continue to own life insurance, the vast majority report that life insurance is a necessity which is primarily purchased and retained for protection purposes. Thus, despite what some critics of life insurance say are the reasons that people buy life insurance, the research data clearly shows that security needs and concerns have always been predominant.

My statement as to the salience of financial security concerns in the 1980's however, is based on more than just the fact that such needs and concerns have been important in the past. Let me share with you some demographic trends that we are likely to witness in the upcoming decade. First, the population of the United States will continue to grow, with the Census Bureau currently projecting an increase of between 15 and 34 million people.

There will also be some important shifts in the age profile of the population. For example, there will be significant decreases in the group between 10-24, and between 45-59, while the proportion of people 60 and older will grow. The most dramatic increase, however, will be seen in the 25-44 year age category.

This, of course, is the population bulge caused by the postwar baby boom, and there should be at least two important consequences of this. First, there should be an increase in the number of households being formed as the members of this age group move through the primary household formation stage of their lives. Second, there should be an increase in the number of children being born as the majority of the postwar baby boom women move through their prime childbearing years, and as women who have put off having children in favor of careers face a "now or never decision."

Now certainly it can be argued that these "Echo Effects" will not occur. It has been suggested, for example, that many postwar baby boom women facing a "now or never" decision with regard to having children will opt for "never" as opposed to "now." I am not here to argue the demographics of the 1980's. The important point that I want to make, however, is that the trends that I have briefly outlined here all point to continuing, and perhaps increasing, needs and concerns for financial security among consumers in the 1980's.

A second desire of the American consumer in the 1980's will be the availability of investment opportunities that are secure, yet provide a good rate of return. Let me offer that one of the major effects of the seventies on the American consumer was that they sensitized the consumer to a whole host of investment and savings mechanisms other than the savings account. Not too long ago, the savvy investor was the one with the savings certificate in addition to a savings account. You do not have to look very far today, however, before you realize that the American consumer is being bombarded with a variety of investment and savings opportunities. Having been made aware of such opportunities, the consumer in the eighties will continue to show interest in investments that allow him or her to keep up with economic conditions as best as possible.

This, of course, assumes that the consumer will have money to invest in the years to come. And in this regard, let me say that it appears that this will be the case. Certainly, some people will point to the record low rates of savings witnessed in the late 1970's as an indication that the American consumer is already spread thin, and will be spread even thinner in the eighties. Many economists, however, now believe that these record low rates of savings were primarily attributable to consumer spending in reaction to inflationary expectations - the "buy now because it will cost more later" phenomenon. Moreover, many economic projections are pointing to at least modest increases in household income and real disposable income during the decade of the eighties.

While I have indicated the belief that consumers have been sensitized to a wide variety of investment and savings mechanisms, I do not believe that this sensitization translates into financial sophistication for the majority of consumers. That is, while many consumers will be aware of investment opportunities, many will not know - nor perhaps be interested in knowing - the intracicies of these products or how they should be used. Thus, it seems safe to conclude that the eighties will see an increased interest in, and need for, personal financial counseling. Such a need has already been documented for the affluent segment of the population in the well publicized study of Consumer Financial Decisions conducted by SRI International in 1978. While this segment of the consuming public will continue to express a need for personal financial counseling in the eighties, I see this need as also extending to consumers in other income segments.

As a fourth factor, let me say that the eighties will see an increasing desire on the part of the consumer for benefits provided by both the government and employers. Some observers of consumer behavior see this as the outcome of a fundamental change in the attitude of the American public - A "Psychology of Entitlement" as it has been called. I have always found this interesting because I think it can be just as easily argued that this "Psychology of Entitlement" is the result of increasing government and employer-sponsored benefits as opposed to the cause of such increases, but regardless of whether it is a cause or effect, the important point is that the desire for such benefits will seemingly continue in the 1980's.

Finally, it is important to note that increases in government and employer-sponsored benefits in turn affect the personal financial needs and concerns perceived by the consumer. For example, there was some indication in our most recent national life insurance ownership survey that consumers may be using group insurance as a partial substitute for individually purchased coverage. Specifically, when income differences were controlled, persons with coverage under group plans had a somewhat lower probability of having individual life insurance than did those with no group insurance. A massive study sponsored by the President's Commission on Pension Policy is also underway at the present time, and this study will examine in depth the effect of social security benefits on personal saving for retirement.

In closing, let me add a few caveats to what I have already presented. First, I have outlined what I see as four major needs, concerns, and desires of the consumer in the 1980's. These are: A) Financial security, B) The availability of investments that offer a good rate of return, and C) Financial Counseling, and D) A desire for increased government and employer-sponsored benefits. Clearly, there will be other needs, concerns, and desires in the upcoming decade that I have not discussed this morning. Some of these I have chosen not to cover because they apply primarily to specific segments of the public. One such example will be the increasing need and desire for retirement benefits and retirement-related financial services as the 60 year plus segment of the population grows. Others have suggested that the increasing number of dual-wage earner families might lead to a decreasing perceived need for financial security through life insurance among this segment of the public.

On the other hand, there are several needs and concerns that are relevant to all segments of the population, but which I have also chosen not to cover in this talk. Examples specifically relevant to the insurance industry include privacy, contract readability and understandability, and cost comparison. I have chosen not to cover these because I do not see these issues as major consumer concerns in the eighties. I think they can be better described as concerns of regulators and insurance companies - whose concerns do not always reflect the concerns of the consumers.

Second, although I have discussed each of these four major consumer concerns separately, I do not want to leave you with the idea that consumers in the eighties will necessarily go about satisfying these needs and concerns separately. Certainly, some have suggested that we are already seeing an "unbundling" of protection and investment needs as witnessed by the "buy term and invest the difference" phenomenon. However, through product development I think future protection and investment needs can continue to be satisfied through a single product or at least through different products offered by the same company. Similarly, some companies are already satisfying their employees' need for financial counseling and their desire for increased employer-sponsored benefits by providing personal financial counseling as an employee benefit.

Third, and perhaps most important, it should be recognized that these financial needs and concerns that I have outlined, while of some concern to just about everyone, will clearly vary in importance for various segments of the consuming public.

Fourth, I think it can be inferred from what I have presented that many of the financial needs and concerns of the consumer in the eighties will be very much the same as in the past, but that the products being used to meet these needs and concerns may no longer be the same.

Finally, let me share with you my view that consumer behavior with regard to life insurance is very different from consumer behavior involving other types of products. As I have already mentioned, the majority of the public views life insurance as a necessity, and this attitude is clearly reflected in the incidence of life insurance ownership among the public. Despite the importance that the public assigns to life insurance, however, our consumer research has always shown that the public is not only very poorly informed on this topic, but also not very interested. The important implication of this is that the public cannot be expected to "build" future products for the insurance industry. Rather, future products will need to be inferred from the financial needs, concerns and desires expressed by the public.

MR. MCMAHON - It is reassuring to know that there are still consumer needs for our products and more important, that there is reason to believe they will have the wherewithall to purchase those products. Our next panelist is Mr. Alan Richards. Alan is a fellow of the Society of Actuaries and is Chairman, President and CEO of the Life Insurance Company of California, soon to be known as the E.F. Hutton Life Insurance Company. Alan is going to talk to us this morning about a new product that he is convinced, at least, fits the 1980's regardless of the scenarios.

MR. ALAN RICHARDS - We are going to see fundamental changes in the life insurance business quite independent of any of the economic scenarios presented here. Obviously economic conditions will affect the rapidity with these changes occuring and the degree to which they are forced upon the industry rather than being adopted voluntarily. The consumer is becoming much better informed on financial matters. That trend will continue quite apart from changes in business conditions.

The central fact of the 1980's is that the consumer's needs and his perception of those needs will demand a completely different approach by the life insurance business.

We cannot continue to pretend that Whole Life cannot be separated into its savings and term components merely because we say it cannot.

Permanent life insurance has some powerful advantages, particularly as regards its treatment for Federal tax purposes. It also has one profoundly beneficial economic and social effects; contributing a major part of the essential pool of long term capital.

The tragedy is that we cling to an obsolete way of presenting the product. Because we are afraid to disclose the interest, expense and mortality components, we pretend they are inseparable and damage our credibility. Further, since we will not reveal the rate of return on life insurance savings in a meaningful way, our detractors, who are less inhibited, are free to claim that the rate is lower than it really is.

I believe that:
1) Permanent life insurance can be broken into its savings and mortality components.
2) The insistence upon presenting cash values as a mysterious composite of several components is a counter productive element in the marketing of life insurance. No other savings medium requires the saver to understand anything but accumulated interest.
3) The consumer should be enabled to see, touch and feel the accumulation of his net savings dollars at the realistic rates of interest which we already use in computing premium rates. The full disclosure of the expense and mortality components will improve our credibility with the buying public and reverse the downward trend of sales of products having a savings component.
4) The "unbundling" of the interest, mortality and expense components will greatly simplify the flexibility of the permanent product. The addition or subtraction of premiums and coverage becomes simple and natural rather than a complicated mathematical and administrative exercise. These complications are quite apparent in the Adjustable Life products introduced a few years ago by two major companies.

Let me briefly describe the approach our company has adopted. We call the product Complete Life. It has the following characteristics:

1) The policyholder specifies the amount of insurance. Including the cash value, this may be level (as with a typical Whole Life plan). Alternatively a level net amount at risk may be specified for a term of years, with the cash value being paid in addition upon death.
2) A series of premiums are stated in the application. These are usually level but may be enough premium and/or cash value to meet the required mortality and first year expense charges. There is no requirement that any premium be paid after the first. Premiums may be increased or decreased at any time. The amount of insurance may also be increased or decreased. Evidence of insurability is required for significant increases.
3) The company makes a fixed percentage deduction for expenses from each and every premium, plus a policy fee payable only in the first year.

4) After these deductions the balance of the premium accumulates in a fund at a guaranteed rate of interest, i.e., the nonforfeiture interest rate specified in the policy, currently 4%. Excess interest is paid on all but the first $1,000 of cash value. Currently the total accumulation rate is 8%.
5) From this accumulation the charge for term insurance coverage is deducted monthly. These charges - based on the 1958 CSO - are specified as maximums in the policy form. A current more realistic charge is actually made for the coverage, but not guaranteed.
6) An annual report is sent to each policyholder detailing the status of his cash value and amount of insurance.

It should be noted that the mathematical process for calculating the cash values is equivalent to the retrospective version of the prospective formula for calculating minimum cash values. If no premiums are paid in a particular month the mortality charges and first year expense charges are deducted from the cash value. This is analogous to the traditional extended term nonforfeiture option. With Complete Life, the insured can resume premium payments without paying back premiums or furnishing evidence of insurability.

We believe our new product may be the forerunner of others featuring the same interest accumulation approach. The potential customer is attracted by the more understandable and realistic return of his savings. The credibility of permanent insurance sales is enhanced by full disclosure of the components. Finally, the flexibility of the plan meets changing needs without requiring the complexities of the administrative system required to deal with the prospective approach.

MR. MCMAHON - I would be very surprised if Mr. Richards' talk does not spark a few questions and discussions at the end of our meeting. We all tend to resist change, and we do not like to give up the old ways. And despite what Mr. Richards says, this is not always all bad. Mr. Barry Blazer, our next speaker is going to discuss some of the products of group and individual that we are working with today. He is also going to describe some new products that may be invented in the 1980's.

MR. BARRY BLAZER - I would like to set the stage a little bit by giving you my thoughts on the factors that we all have to live with, and that will affect the products and services that we provide. Mr. Zultowski talked about the consumers' attitudes and needs and he touched somewhat on two other factors that are most significant in my view. The first is economic conditions, the combination of very high inflation, high interest rates and an uncertain money market. All have a tremendous impact on our practices and business. The second factor is the fierce competition for savings dollars. My own view is that we have to provide consumers with a better understanding of the differences between the insurance element and the saving element in the products that we offer.

In addition, we will be concerned with the greater and more effective use of computer facilities and capacity; and finally, with the regulatory environment. It seems that more people are looking at what we do almost on a daily basis - insurance department, the IRS, the FTC, and the SEC. We are faced with broader regulation and potential regulation that we have ever had before. We certainly recognize how much of a factor the Internal Revenue is in shaping the products that we offer.

Let us move on to the characteristics of products in the 80's. The first thing that we will see is a continued trend toward more flexibility and sophistication of products. Whether they are akin to the universal life approach that Alan described, the adjustable life approach introduced a few years ago, or some third approach not yet developed, is not clear. We will probably see products coming from all directions. All will provide the consumer the flexibility to choose and then change the type of and amount of coverage. These products will provide fewer guarantees, particularly in the areas of rates and cash values.

We will also see a continued blending and bundling of life and annuity products. There will be a growth of products that I would describe as tax-advantaged products - that is, the cost of the product will be paid with pre-tax dollars. The use of group and mass marketing techniques will increase, resulting in part from the need to serve the lower and middle income markets. With that, we will continue to see more efficient use of the payroll deduction form of premium payment. Group marketing of casualty coverages will increase both to meet employee expectations and to fight rising costs of coverage and administration. There will be a shift in marketing emphasis towards the higher middle income market. That will be due in large part to the increase in knowledge required to deal with some of the "sophisticated products" that are being presented today. There will be pressure to reduce the distribution costs in some market areas, if for no other reason than to compete with the other saving opportunities that the public will have. People in the insurance industry have expressed a great deal of concern about cost and compensation disclosure. Regardless of how the disclosure issue is resolved the industry will be faced with pressure to reduce distribution costs to compete for the savings dollar.

Before making specific comments about some of the products that were listed in the program, one general comment on tax-advantaged products is appropriate. We can expect revisions, either by the Congress or by the IRS affecting many of the products that currently enjoy a tax-advantaged status or that we are seeking a favorable ruling for. During the decade the IRS is likely to try to close some of the discriminatory loopholes that may exist in some areas. I am optimistic about the possibility of an increase in the $50,000 non-tax limit for group insurance at some future date.

A few comments on retired life reserves - right now this represents a major special market despite the current tax uncertainties. At present insurers can provide companies with a vehicle for taking a current tax deduction for the cost of providing insurance on future retired lives. One of the questions, of course, that will be dealt with is whether the insurance industry can treat interest earned on retired life reserves as an interest paid deduction or whether the unsegregated or unallocated funds will be treated as insurance reserves for tax purposes. The success of the product in the long run is likely to depend on the availability of broader group-type coverage with both the cost efficiencies and the flexible funding arrangements possible through a group program.

On the subject of group insurance, I see greater interest among employers in the cafeteria approach to benefit plan design. This is more feasible today since some of the more serious administration problems may be handled by the computer resources and facilities that are now available. There are still administrative problems to deal with, and the IRS must act on the deductibility question for some of the coverages in the cafeteria plan. Also in the group area, a number of insurers are expanding their group insurance portfolios into some of the less common areas such as vision care. Others, concerned with mounting losses are introducing more stringent underwriting requirements, modifying provisions and streamlining coverages. We are likely to see in the 80's an increase in the use of group-type products to provide auto and homeowners insurance. Such programs would initially be employee paid rather than employer funded. Mass marketing programs using payroll deduction techniques will provide a significant new outlet for traditional permanent insurance products, particularly to the lower and middle income market. Greater use of muliple policy billing, credit cards and electronic fund transfer facilities will help the industry deal with rising operating costs.

In the time remaining, I will offer a few thoughts on possible future developments. The industry will continue to offer permanent insurance plans, but not in the traditional sense. We will see such programs operating without guaranteed cash values. A second development could be an evolution towards what might be called guaranteed renewable life insurance. The rates charged at renewal would be established on a class basis, such as we now have in the health insurance area. One final prediction -- product development in the 80's will attempt to provide the equivalent to perpetual motion -- inflation-proof insurance.

MR. MCMAHON - That is certainly a comprehensive review of today and tomorrow. Whenever you are working on something new and innovating, it is always a good idea to look back and see what the ancients called it. But if you cannot do that, then look around the rest of the world and see what they call it or what they are doing. We are fortunate today to have a young man in the audience, Mr. Michael Tuohy, who has offered to tell a little about product ideas of other countries.

MR. MICHAEL TUOHY - The majority of my comments will deal with the situation in the United Kingdom market which has been one of the most innovative in the world. This has primarily been due to the lack of restrictive insurance legislation. Most other European countries with the exception of Holland have strict life insurance regulations which have inhibited product innovation.

When viewing what has happened in the U.K., it is important to understand the favorable tax treatment given to life insurance products. Tax relief is generally allowed on the payment of life insurance premiums for policies under which at least ten years' premiums are payable. The level of such relief has been equivalent to a negative premium tax of about 15%. Investment income within the life company is taxed at a favorable rate and the proceeds of the policy are tax free to the policyholder. Obviously, this gives regular premium permanent business an edge over other savings media with regard to after tax returns.

Due to this favorable treatment, the U.K. market has been dominated by endowment and whole life business with little term insurance being sold except in the form of riders. Traditionally, orthodox participating policies were sold. However, in the early 1960's, several new companies were formed specifically to market equity linked business. The types of product sold were much simpler than the variable life products introduced in the U.S. Typically, a given percentage of each premium would be allocated to purchase units of an equity fund and the cash value would equal the value of the units less a surrender charge. The face amount would increase by any growth in unit values. Production of this type of policy increased sharply during the 1960's and the new unit linked companies quickly established a significant market share.

In 1968, a product linked to the performance of a property portfolio was introduced and quickly became popular. Later, further links were introduced depending on market conditions. Fixed interest and cash funds are now available, also managed funds which contain a mixture of property, equity, fixed interest and cash. In the early 1970's, legislation was introduced which effectively outlawed all other links, as there was concern that exotic links such as commodities, works of art, and even postage stamps were about to hit the market. However, the availability of different links has been important in the continuing success of the unit linked business. When the stock market fell, this did not seriously affect production, as policyholders moved to property links or fixed interest links. With the early products, this caused disintermediation problems, as policyholders were encouraged to cash in the policy with the original link and purchase a new policy with a different link. This disintermediation problem has now been solved as most policies allow the policyholder to switch his investment medium without cashing in.

Production of unit linked business showed resilience in the times of high inflation experienced by the U.K. in the early 1970's. In 1970, the IOS bubble burst and in 1974 several new companies that had been selling income bonds became insolvent. An income bond was a product similar to a single premium deferred annuity. These were the first life insurance insolvencies in the U.K. this century. The public's reaction to these events was to move back to the solid establishment companies. As most of the unit linked sales did suffer s setback. However, the setback was only short-lived and unit linked business quickly regained its market share. Since that time, most establishment companies have either formed unit linked subsidiaries or introduced unit linked products into their protfolios.

In summary, unit linked products in the U.K. environment have proved popular in inflationary times but that may well have been a short-lived success if links other than equity had not been available. The Dutch, who where the inventors of unit linked life insurance, experienced significant sales of equity linked business during the 1960's. However, the sharp reversal in the Dutch equity market, combined with the demise of the IOS organization, caused sales to drop, a position from which they have not recovered.

It is clear from the U.K. experience that it is important for the policy to appear simple to the policyholder. Some of the earlier linked policies were extremely complicated from the policyholder's point of view and did not sell.

To finish, I would like to reiterate a point made by Mr. Richards. In inflationary times, orthodox life insurance is at a disadvantage to other savings media in that the high rates of return used in the computation of benefits are not visible to the policyholder. The linked policy overcomes this problem and the policyholder can see that he is benefiting from such rates of return.

MR. MCMAHON - We are now at the point where we can open up for discussion and questions from the floor.

MR. RICHARD MURPHY - I will start off with the obvious question to Mr. Richards. I believe that there have been some private letter rulings requested by Life of California on several income tax issues and possibly a question on par or non-par with respect to your product. Can you tell us the status of those rulings? Have you had your conference, or are there any letters forthcoming?

MR. RICHARDS - We believe that is a foregone conclusion because we can demonstrate very easily a simple mathematical exercise that the cash values according to this plan, are the same retrospectively and prospectively as they are with any life insurance plan. We have requested a ruling to the effect that this is life insurance under Section 101.

MR. HARRIS BAK - One thing that the Complete Life Product that Mr. Richards described has in common with Adjustable Life and Traditional Life insurance policies is that they are life insurance products. As life insurance they must have a policy loan provision. Currently, we have the maximum policy loan rate in all states at 8%, and we have prime rates at 20% interest. Particularly since we are isolating the investment element, how can we use this product to compete for the savings dollar when we can't pass on effectively more than 8% interest?

MR. RICHARDS - We have handled this in two different ways; first in California and perhaps in some other states, we have a 8% conventional type policy loan provision. Second, we have created policy language which provides that for any money that you would borrow from the program. We charge a very low rate of interest but we also suspend the accumulation of the excess interest on the policy form.

MR. BRUCE NICKERSON - In determining your treatment on excess interest on the accumulated fund, in what manner do you take account of implicit capital losses when the market interest rates skyrocketed recently?

MR. RICHARDS - We have not made any implicit adjustment as yet. Obviously, if it really is excess interest, ultimately that kind of an event should be reflected in the rate.

MR. JERRY GILDEN - I think the Mr. Blazer said that in the future products would be advantaged to disclose the interest basis for accumulating funds and analagized that to money market funds where you can easily determine the interest rate. Mr. Richards, how is the 8% interest rate derived from the gross interest rate of the company in your product?

MR. RICHARDS - We are merely disclosing the size of the fund, the deductions from the fund, and the rate that we are currently paying. We are not disclosing how it is derived.

MR. ARDIAN GILL - I have a suggestion for Mr. Richards on his product and the scorekeeping of it. This comes from a paper by Mr. Maurice Levita, which is in the proceedings of the Conference of Actuaries. Maurice suggested some years ago that this type of product could be very simply administered by treating each premium as buying extended term insurance. And each succeeding premium, if there is one, extends the term or if the face amount is increased, it might reduce the term or otherwise adjust it. Mr. Blazer mentioned the competition for the savings dollar. We have all heard for many decades that the life companies were losing their share of the savings dollar and you know it is just not true. The latest fact book gives percentages of disposable income that is flowing to the life companies and it is surprisingly constant over the last decade or so. A more accurate statement might be that the life insurance product is losing its share of the dollar but the life insurance company is not. You have to go just beyond that to see where it is coming from. It is coming in on the annuity line. Of course, group annuities are very strong influence but so are tax qualified annuities and since we are talking about the industry as a whole, the single premium deferred annuities have been an important factor. The point is that life insurance may have a problem but there are other savings vehicles and Mr. Richards product may be one of them. There are other distribution systems and his may be one of them that may have a solution to this dilema. One solution brought up Mr. Tuohy is the link. We have the mechanism here in the form of separate accounts and I've seen several filings of the mutual fund group where they are going to offer technically a variable annuity with the assets in any one of separate accounts. A number of unit trusts, and you can choose your mutual fund, so if you imagine you have it in money market instruments you have got a thru-put in the separate in the full current interest rate in what would technically be a variable life or variable annuity product. One final comment for Mr. Blazer, is that he indicated a shift to the higher income markets and I point out that we, the life companies, are in that market. So it is not a shift to a higher market so much as an abandonment of the lower market.

MR. RICHARDS - I still think as I did some years ago, that the nonforfeiture laws should still be changed so as to make this kind of a product more easy to design. What we did was totally within the standard nonforfeiture law, but it was very difficult. We had to make a lot of things comform and do a lot of work to do indirectly what would have been much easier if we had been able to do directly. I think the standard nonforfeiture laws should be made flexible enough so that this kind of product could be put together with far less work than we had put into it.

MR. BERNIE RITTERBUSH - Mr. Richards, would you summarize the distribution system you are using and the compensation of it, the training of it, and what kind of market success you are having so far?

MR. RICHARDS - Number 1 was the compensation - I cannot be precise in this room because it is a fairly complicated compensation structure. We take a portion of the level charge, which is 7½% of each premium, and give it to the agent and we also give him the entire $250.00 first year charge and the amount per thousand of insurance. I really cannot generalize as to the compensation level. However, for plans which are heavy on the savings element, the compensation would be considerably lower than a typical traditional whole life policy. Training - you train for this as you would train for any other product. Actually in some ways it is simpler. You do not have to talk about a lot of different products, you merely talk about the policyholder providing a sum of money, whatever he likes one to provide us with, and we make certain deductions and the balance is accumulated.

Our distribution system is quite complicated. We are a wholly owned subsidiary of E.F. Hutton, and in fact we are changing the name of our company to E.F. Hutton Life Insurance Company some time in the future. We are selling this product thru the account executives and surprisingly so far we have sold more of the product or a greater portion of the sales have been made outside of that field force. I think ultimately that is a very logical way to sell this product. Account executives should be able to relate to that kind of logic better than the other products. We have general agencies, we have the reminents of what was once a very large mutual fund sales force, and they have the proportion of the sales in that particular distribution system and that is larger than any of our other distribution systems. We have the PPGA's brokers, you name it, we've got it. As for sales results - it counts for something like a third of our sales so far. That's about what I believe adjustable life accounted for at this stage of the game in the top two companies that had that product.

MR. BURTON JAY - Maybe this is a question that is obvious to the others here, but I'm still a little confused. Mr. Richards, you have a level 7 1/2% charge on the cash going into your fund plus a policy fee the first year, and you deduct amounts each year equal to the costs of the amount of insurance specified. You also say that you have minimum cash values that are equal to the retrospective version óf the standard nonforfeiture formula. It seems to me that the fund you actually accumulate would only be equal to the result of the application of the non-forfeiture formulas by accident.

MR. RICHARDS - There is a mathematical equivalence because it also includes the accumulation of the excess interest. It is the exercise we all went through as students demonstrating the retrospective and prospective formula. I made the comment that we had to do a lot of work to make the two conform, but we were able to do that. It would have been much easier if the expense allowances in the standard non-forfeiture laws were expressed in a different manner or in a way in which we actually charge them. We were able to make some equivalences and demonstrate the equivalences and we have approval in 39 or 40 states.