RECORD, Volume 24, No. 1*

Maui I Spring Meeting
June 15–17, 1998

Session 44IF
Corporate-Owned Life Insurance: Trends and Outlook

Track: Product Development
Key words: Marketing, Product Development, Underwriting

Moderator: TIMOTHY SIMON MILLWOOD
Panelists: IAN ARTHUR GLEW
CHRISTOPHER L. PARKER
GARY THOMAS
Recorder: TIMOTHY SIMON MILLWOOD

Summary: This session focuses on current trends in the marketplace (e.g., product, marketing, Corporate-Owned Life Insurance concepts, underwriting, systems), what to expect in the future, and how a carrier should position themselves to be a dominant player in the 21st century.

Mr. Timothy Simon Millwood: We have three speakers. Ian Glew, who's with CIGNA, here to represent the carrier's point of view. Chris Parker, with Clark Audit, is here to represent the COLI brokers and, finally, Gary Thomas, with William M. Mercer, Inc., is here to represent the consultant's point of view.

Our first topic will be on tax legislation. Then we'll move into trends and product design, the general movements and general account products to separate account products. We'll talk about the fact that buyers have become more sophisticated. Most people buying COLI these days know what it is and have some experience with COLI, be it good or bad. They know what to look for. We'll talk about trends in underwriting limits and the fact that guaranteed issue limits have gone up. Finally we'll get into the fact that illustrations are becoming more and more complex, and real illustration issues and finally administrative issues associated with COLI. I'm going to let Ian start first on the legislative front.

Mr. Ian Arthur Glew: There really is a very mixed bag on the legislative front this year, as people in the audience who suspect you are in the COLI business will know, this is just another year in which there has been some legislative activity. The administration's budget proposal included a provision that essentially would have disallowed a certain portion of interest deductions if the business ran like it should. There is no grandfather provision or safe harbor. That was obviously the position of the Treasury as well.

The Congressional Joint Committee on Taxation essentially supported that view that Treasury had the best foot forward. However, they seem to be much more willing to provide grandfathering, and they also seem much more willing to provide a safe harbor. When the proposal moved over to the Senate Finance Committee, initially there seemed to be some support for the proposal. But as the weeks went by it became clear that generally in terms of both people on the Senate Finance Committee and in particular the people on the House Ways and Means Committee, they really don't have much of an appetite this year for any legislation on the COLI side. They really want to get back to their constituencies and start campaigning. They don't really want to upset anybody who’s here. However, they do seem to be willing to consider it again in 1999.

To make matters even more complicated however, some of the largest producer groups seem to prefer to try to control the situation on the legislative front, and they are actually putting forward their own proposal than actually pushing for legislation this year. I think that if it weren't for that particular push we could probably feel fairly positive that there would be no legislation this year. But given that, I think there is a small possibility that there could be some legislation. I think almost definitely that would include grandfathering. I think that it would include some kind of safe harbor for smaller cases. One that would be mentioned is the $100 life limitation. Another one that would be mentioned is $20–25 million of premium for a year.

My view is that if nothing happens this year, we will see this back on the table in 1999. We are now regarded by some members of Congress as being a strong source of revenue for future goals. In fact, some people regard us as being the next best alternative after some form of a tax on tobacco. Once you're on that list it's very difficult to get off of it. I think that we will probably see some legislation in the not too distant future. This will most definitely include grandfathering and probably include some kind of a safe harbor. Anything beyond that is probably speculative.

Mr. Millwood: Ian, I actually have a question for you. Now that the legislation has sort of fallen to the wayside, what have the impacts been on COLI sales?

Mr. Glew: I think that there has been quite a dramatic impact in the large case market. The initial proposals were directed very much we believe in the bank market because banks are the ones that have the highest level of unrelated debt. Therefore, any limitations on interest deductions would impact banks more then anything else. What we saw was a pretty dramatic fall off in the bank-owned life insurance (BOLI) business in terms of activity. Although most carriers tried to simulate that activity by offering banks the opportunity to get out of the transaction in the event of adverse legislation by offering extended free-look. I think they've adopted a fairly conservative view and probably most of them won't want to be caught in legislation trouble.

That is thought of as well and some of the other large COLI sales, where there also appears to be some activity in the market with smaller transactions. Activity's very strong, doesn't seem to have impacted that end of the market significantly.

Mr. Millwood: Just as a matter of interest, how many of you in the audience are actually involved in COLI in some form or fashion? Would you tend to agree with Ian that legislation is thought to dampen the larger sales? Let's move on to the next topic, the general movement in product design from general account products to separate accounts.

Mr. Glew: For those of you who are operating in the COLI market I'm sure that this will be a noticeable trend, particularly for those of you who have operated in that market for some years. If you go back six years or so, around 80% of the business that was written in the COLI market was general account business. About 20% of the business was variable business. If you poll most of the companies now it's entirely reversed. There are 20% general accounts and around 80% is variable. There are I think a number of significant drivers behind that. There is the obvious one, which is that the equity markets are performing and are performing better than fixed-interest markets. It's driving the growth and variable business not only in the COLI market, but in the annuity market and the retail market as well. But beyond that there are some significant drivers to that.

One of them is that most COLI programs incorporate an element of cost recovery. Cost recovery is a return of premium after time. Alternatively, it is a return of premium to the corporation on debt. It's very common and typical in most COLI programs. It has a lot of appeal to chief financial officers (CFOs) to know that they're ultimately going to get their money back, and all that they're losing is the time value of money.

Cost-recovery-type programs do not work particularly well in a 6–6.5% or 6.75% general account interest rate environment. They are very, very sensitive to interest rates. They work a whole lot better at 8%. They work even much better at 9%, and of course, you can illustrate variable contracts at a higher rate. Also, if you look at the history of the equity markets they perform at a higher rate as well.

When in fact you try to put and design a lot of these COLI programs, these days in the low interest rate environment, if it has cost recovery you really need to move a lot more toward the variable side. I think a second major driver is that the COLI market has changed. The use of COLI products has changed dramatically over the years. COLI products were originally set up largely for group carve-out type programs. The primary concern was the death benefit within the programs. More recently, of course, they're being used much more for the financing of corporate liabilities, and, in particular, for the financing of deferred compensation and SERP type liabilities. Under the third compensation side, there was a very strong trend to allow people to have individual accounts set up, and allow them to direct where their deferrals are going and what they want their deferrals linked to in terms of investment performance. Going back half a dozen years, most deferred compensation arrangements just track Moody's or some sort of a fixed interest index plus some amount of money. A general account product was great for matching that. But when you move into the newer forms of deferral accounts which look much more like 401(k)s, if you're going to try and match it with any kind of an investment, you need an investment that has investment flexibility. That's another reason that variable products are growing.

The third reason is buyer sophistication. I'll allow Gary to get a little bit more into that. But I think that buyers want a higher level of disclosure in their products as well.

Mr. Gary Thomas: Yes, just to expand a little on the nonqualified deferred compensation market. Non-qualified deferred compensation programs have simply expanded enormously in the last four to five years due to the limits on 401(k), and also, indirectly through the limits on defined benefit qualified plans. A lot of companies that previously may have offered non-qualified deferred compensation plans now have seen the liabilities or the potential liabilities growing large enough that it becomes feasible to actually finance them with variable COLI, and get into what I would call wholesale products, which have much leaner loads and which are much better priced then some of the individual products that have been used in the past.

Ian also mentioned the fact that cost recovery really doesn't work so well in a low interest rate environment. One area in which cost recovery is very important is in collateral assignment split dollar plans, where the postretirement income or postretirement death benefits are financed out of the gain in the contract. If you're buying life insurance and you're trying to fund over a fairly short period of time like 15 or 20 years, and the policies are only earning 5–6%, it's just not going to work in a lot of cases. We've seen several cases where companies have started putting in variable split dollar arrangements. Those have their own problems. They have special management problems that have to be dealt with, such as, who gets to select the funds that the cash valves are invested in?

Disclosure is important with the largest COLI cases; in the last several years those have generally been BOLI cases, where the amount of premiums invested has been in excess of $100 million. Because you're dealing with such a large amount of money they generally get the attention of the most senior financial people in the bank. They want to make sure that they fully understand what they're buying. In particular, the thing they're most concerned about is the level of discretion that a lot of insurance companies still have on the policy, even when it may seem like things like the charges may have certain guarantees. They may have mortality and expense charges, which have a lower guaranteed level than you might see in some retail products. They're still concerned with things like exactly how does the mortality experience rating work? Is it done fairly? Do you credit interest on the incurred but not reported claims (IBNR)? If so, how do you credit it? There's a lot of pressure on full disclosure of just about every element of the product. I think that seems to work best with the large private placement of variable products. I think that's something that's been pretty pronounced.

With bank-owned life insurance, it was only a few years ago that it was fairly common to see general account BOLI, which involves a certain amount of trust from the bank towards the insurance company that the interest rates that are credited will be done fairly from year to year and will be consistent with what was originally illustrated. There have been several products that have been developed in the last couple of years, which are variable kind of products that retain certain types of guarantees as to the rates that will be credited. That's something that gives the banks assurance against one of the things that they're most concerned with, which is marking to market. There's a worry on the side of the banks that they're going to put a lot of money into this product, and all of a sudden, the stock market is going to go south. That really hits their earnings, and it's something they're very concerned about. This has led to the recent development of some unusual types of variable contracts.

Mr. Roland R. Rose: Regarding the general account products, what is more common—portfolio rate or new money interest rates? Just in your experience. I'd appreciate your views on that.

Mr. Glew: Like anything there's never exactly a simple answer to that. If you look at the products that are typically being used for group carve-out programs, and the financing of small deferred compensation programs, I would say the more typical way is the portfolio approach as opposed to the new money approach. If you look at the BOLI market, it's much more typical if the general account product that's being used is new money. Essentially the difference is, in those first two categories I spoke about you would expect that there would be ongoing recurrent premiums. Most BOLI sales are single premiums. In situations where there are single premiums companies tend toward new money, and situations where there are ongoing recurrent premiums, companies tend toward portfolio approaches. But there are exceptions to those situations.

Mr. Denward Chung: On the variable products is there any kind of minimum guarantee or is it total pass through? Take your lumps with your gains?

Mr. Glew: If you're referring to the investment side it's total pass through typically. But once again, if you look at what's happening on the BOLI side, what people want is stable values. Some large investment organizations have been prepared to offer stable value hedges that go inside of the separate account. Essentially you will have an investment portfolio that will be a fixed income portfolio of sorts normally tracking the Leeman index plus some differential. Then there will a separate security essentially that is inside the separate account that will be providing a stable value hedge. That provides essentially a book value kind of guarantee, so if people want to exit the policies they can get out something that is more akin to book value. But if you're looking outside of that special application in the bank market, most of what you see is the straight pass-through, because most people who are buying COLI products are looking for highest performance, and guarantees drag performance down. Unless you really need the guarantee typically it is not in there. There are a couple of variations. I think that you're beginning to see a few companies taking a little bit of an interest in equity-indexed kinds of arrangements. But they're not particularly prevalent as yet.

Mr. Richard D. Schaefer: Do you feel that the switch to the variable products is a permanent change, or that a substantial flattening or a down in the stock market could reverse the switch to variable product?

Mr. Thomas: I think it's a permanent change. There are lot of interesting parallels you can draw on the BOLI market. In the BOLI market, there are two essential products that can be used. There's the regular general account product, and there is a stable value guarantee product. To the end consumer, to the bank they're providing exactly the same thing. They're essentially just providing stable growth in cash values. Yet, since the stable value variable products have come into being 2 years ago, they have captured particularly on the large case market 50% of the market. Why have they captured 50% of the market when essentially what they're offering is exactly the same as the general account product? After all, the one doesn't perform better then the other long term. The reason is, consumers are more sophisticated. They want the disclosure and they want the additional investment flexibility. They want to have the ability to change what happens inside and on the investment side without having to go and buy another product. My view is that the growth of variable business only has a little bit to do with the growth in equity markets, and has a lot to do with what buyers want. What buyers want is greater levels of disclosure and more investment flexibility. I think that if the equity markets come down, you will see carriers coming up with alternative investment options that allow people to get out of the equity markets, but I don't think that people will switch back to general account.

From the Floor: Do you think people have also moved toward variable for the credit protection?

Mr. Thomas: They have moved toward variable for the credit protection absolutely. I think that if you draw a parallel with what's happened in most of the overseas markets, the U.S. has been slow in getting to the variable business. Mainly not because buyers didn't want it, but because the regulatory environment was not friendly toward selling their old business. Now that most producers are National Association of Securities Dealers licensed and affiliated obviously under those circumstances with a broker/dealer, what you're in fact seeing is that consumer desires are now being met. Once they are met I think it will be changed. But to get back to your question, I think it clearly has to do credit protection as well.

Mr. Glew: Actually a prime example of that is in the BOLI marketplace where banks are looking to buy variable account product, but invest in investment-fixed income funds. You can get the same types of returns.

Mr. Christopher L. Parker: If I can add to some of your comments away from the BOLI market for a minute. What we're seeing is that there's probably a fairly permanent shift of variable products from a deferred compensation funding perspective. The reason is that the executives like the flexibility of being able to allocate their money, similar to what they're doing in a 401(k) plan where they're allocating it to a different fund. They can choose what funds they're in at any particular point in time. The corporation then is buying the insurance that essentially is duplicating their liabilities. From an asset liability perspective corporations are in a situation where they don't have a lot of risk. We can match up the assets with the liabilities through the different funds balance act, whereas, on the general account product, they may have been able to do that fairly well or they may not have. They're at the mercy of the carrier in that instance.

Mr. Thomas: Just a couple of other comments about the shift to variable, which I think are of interest. One of the things that the shift to variable products in the COLI market has done is it has lowered the barriers for entry of new competitors into the COLI marketplace. The reason why that is this has happened is that some years ago, when most of the business was general account you could not write business in the COLI market unless you had $10 billion of assets, and you were rated in the top 2 categories among all of other rating agencies. If you didn't have that you weren't going to write COLI business of significant size. Once you got around that through the credit protection that is afforded by the separate account, that has meant that a whole lot of people can now enter the COLI market with variable products who were previously excluded. What you've seen in the last two to four years, is the number of people who are competing in the COLI market. The carriers competing in the COLI market have doubled, which I think has been good for the consumer. It hasn’t been as good for the people who were the traditional carriers in the COLI market. I think that is a trend that will continue because there is really no reason why anybody who doesn't have expertise in the variable insurance business cannot acquire administration support and those sorts of things cannot be in the COLI market these days, whereas before they were excluded from that. It also means that now that we've got a lot more competitors. It means a lot more impetus for product differentiation in the marketplace. The other thing that is important I think for the carriers that have been in the marketplace for quite some time, is that variable products carry lower levels of required surplus. Therefore, lower levels of earnings are associated with them. If you were a general account writer in the COLI market, and you're not a variable writer, you got to write a lot more variable business to make the same amount of money that you were making when you were previously writing the general account products. Those are some of the impacts that I think carriers are faced with as a result of this trend.

Mr. Ralph Gorter: In the COLI market as opposed to the BOLI market, what trends do you see in terms of private placement sales versus registered product sales?

Mr. Parker: I'll field that one. Actually, what we saw a few years ago was a big movement toward private placement. There certainly was a lot of activity going on around 1994 or 1995. It seemed like for a while that registered products were out of favor. But as we got more and more into it, and I think that the sex appeal, if you will, of private placement wore off a little bit, registered products got more advanced. There's more repricing coming out of the registered products to make them more competitive. There's more disclosure going on. We're seeing a shift back toward the registered side almost exclusively in the last couple of years. We've been putting registered products and not allowing the private placement side with the exception of the very large jumbo size cases, where maybe you got a consultant involved and return premium or something. In that case, you're still going to see private placement activity. But I think going forward you're probably going to see the registered products getting more refined and that's what the brokers want to sell because that's where the money is at.

Mr. Millwood: I actually had a question for Gary. One of the trends that seems to be among the larger cases is that they all want to get their mortality experience passed back. Do you see some transfer of risk issues that might eventually surface?

Mr. Thomas: I guess that's always something that's out there. It's something that a lot of our clients have looked at. But ultimately they have decided that it's a risk that like any other risk they're prepared to take. But I would say that we've seen particularly in the largest cases that some carriers are pretty much prepared to turn everything back to disclose everything and to define the IBNRs precisely, define exactly how you'll get your dividend and when you'll get your dividends. Again, with those types of cases, the number of lives is generally large enough and the amount of risk transfer is fairly small. I guess it may be an issue. But it hasn't been anything that slowed people down.

From the Floor: I have a question for Ian. Typically, COLI products to date have been what I consider fairly simple products; not a lot of bells and whistles. Do you see that changing in the future?

Mr. Glew: Yes, in fact I do. I think that with the increased number of competitors coming into the marketplace, and a lot of them being people who are very strong in what I would call the retail business, the noncoded business, a lot of those carriers being strong in the brokerage end of the retail business, you're going to see some of the techniques for differentiation that are used in the retail brokerage market begin to find their way over to the COLI. I'm not sure just how receptive the COLI buyers are going to be to that. But that doesn't mean to say that those carriers are not going to try to introduce those things. I think that they fall into a few categories. Number one, on the retail side what you've seen is a lot more grading on underwriting classifications. You are now going to have six to eight different levels of preferred and three or four different levels of smoker and people have different ways of doing that. The COLI market up until now has being relatively simple in terms of the number of different classifications that it has on the underwriting side. It would not surprise me to see a move toward having more differentiation of what I would call standard business, standard guarantee issue (GI) business, or standard medically underwritten business. It's probably already over on the standard medical side. It's just carried over anyway. But it wouldn't surprise me to see more grading on the standard GI business, where people are basically going to say, "look if a group fits into this particular category on these kinds of dynamics, we'll call you Class A GI and these people will be Class B GI" and that sort of stuff. That's one area where I can see some trends appearing.

The other thing that we will likely see is that one of the big things on the retail brokerage side right now is providing stronger secondary guarantees in contracts which are if you pay this level of premium we guarantee that you'll get this level of benefits over the next 20 or 30 years. People seemed to have gotten comfortable with that and some of the reinsurers seem to be prepared to support companies in doing that. It wouldn't surprise me to see attempts being made to bring some of those secondary guarantees over to the COLI side. Even though it doesn't appear as if the COLI clients right now are necessarily looking and asking for that. I made the comment earlier that people don't necessarily seem to be willing to pay for that. But if, on the other hand, the secondary guarantees can be provided with little or no cost, they could find their way into our market.

The other trend that I think that we're likely to see in the future with regard to development is a lot of the innovation that is occurring on the retail side around investment options, inside of annuity contracts, in particular, which you find in the way of life insurance contracts, we could find coming into the COLI market, because the COLI market is essentially an investment-oriented-type sale. To the extent that people can come out with investment options that have flaws, guarantees, caps, indexed, and all of those kinds of things, it wouldn't surprise me to see that coming over as well. In terms of which direction is the COLI market going to head? I think you should look at what has happened in the last three or four years over on the retail brokerage side.

Mr. Gaetano Geretto: Ian, I'd like to discuss that first issue further with you, which is the underwriting classifications. Increasingly in the small- to medium-sized market we're seeing people who are having, if you will, a very gray GI or a very white simplified issue (SI) coming to market. I'd like to hear some of your views on that. Increasingly, to get to those risk classifications that you're talking about, if you want to call it preferred GI for lack of a better term. How much more evidence is needed and how is that going to impede the sales process if you have to get more evidence on the issue?

Mr. Glew: We have a section coming up that's going to cover GI in more detail. But let me just kind of address that from my perspective. I think that that is one of the trends you're going to see. COLI is moving down market to some extent. I think that what we're finding is that the very large case market, I won't say is saturated by any means, but a lot of activity has taken place over the years. People are looking increasingly to the middle market. The middle market is very broad. It goes all the way from companies that maybe only have 200 or 300 employees to companies that maybe have 5,000 employees. If you've got a company with only 200 or 300 employees, chances are it only has 15 executives who are going to be on the deferred compensation plan. Most GI programs only start at 20 or 25 lives. If you need to have $500,000 or $1 million of coverage for 15 lives, then you're going to have to do something different from the standard GI arrangements. You also typically don't want to go in and underwrite all 15 lives because that makes the sale that much more difficult, so the companies right now are trying to figure how to deal with that. How do you deal with groups where you want to provide some kind of group underwriting, but you don't want to provide for GI? I think the different companies will come up with different solutions in that area. But it's clearly an area that's being looked at by a number of people right now.

Mr. Kevin D. Mackay: It strikes me that that's a good strategy, particularly for folks like you who have been in it for a while. If you can collect the data that you need to do some sort of differentiation in terms of what kind of underwriting information you get, you could actually offer a better GI or some sort of value-added that would allow you to separate yourself from the new entrants who don't have that historical experience.

Mr. Glew: Yes, I think that that is right. Unfortunately I think that on the GI side, on a case level basis, you don't really have as much data as you ideally would need to start to do that, because what we're talking about here is case level underwriting as opposed to individual underwriting. You need to have a number of people from different industries and different kinds of classifications to really get a feel for that. But I do agree with you in terms of that to the extent that you can find differentiators on the GI side that would work. That would allow you to do exactly what happened with the smoker and nonsmoker, or what happened with the preferred and standard, which would be to go after the better risks with a lower price than your competitor.

Mr. Thomas: We've seen some cases where they've used company physicals to give some kind of preferred rate.

Mr. Glew: That's right. I'm sure that Chris and Gary would probably want to comment on this. But I think that to the extent that you're a producer you can avoid having to take people and put them through new medicals. You certainly enhance the chances of a sale. If you can use existing executive medicals, if you can use old data or anything that doesn't require those executives to go out and take the new medical has to enhance your chances of getting the sale through.

Mr. Thomas: I think the only type of cases where it's acceptable to go through medicals are things like split dollar plans where the participants themselves are going to get some kind of benefit from it. Even in those cases it's a real nuisance trying to round people up sometimes.

Mr. Geretto: I don't know if you've touched on this issue earlier, because I got in here a little bit late, but it's the whole issue of increases in stacking. Certainly being a reinsurer, I think different reinsurers have different views about what should happen. But obviously you people are much closer to the market than we are. There seems to be some pressure to get increases a bit over the 100% level on initial GI. There's obviously pressure to get the ultimate amount of GI to be much higher than it should be. We just had a discussion about whether it should be GI or to make it simple. Let's talk about the face amount of coverage. Where do you think things are going? How can we in the reinsurance community help you to satisfy your client's needs?

Mr. Millwood: Do you want to move on to the underwriting topic now?

Mr. Glew: Yes, let's talk about underwriting. If I may, let me start off a little bit before that and because I think stacking and everything that's associated with stacking is just part of the evolutionary process that has occurred in GI underwriting. It may be helpful to start at the beginning and just make a few comments as to the progression that's occurred over the last several years.

When COLI business really got going back in the mid 1980s it was really driven by group carve-out type plans, where executives were being given benefits that were related to multiples of salary. You were replacing what was in the group life programs and the group life programs are written on a GI basis. GI became pretty much the norm for larger cases on group carve-out. First of all the purpose of those programs was to provide life insurance coverage for executives. The higher you were on the executive scale, the more life insurance you got. It seems the top decision makers got the most coverage.

The whole GI process and all of the parameters that were put around GI was directed at curtailing the amount of coverage that those decision makers could get. Typically in group carve-out programs you would find that the GI only impacted a half a dozen people. The other hundred people that were in the program were not impacted. That's the way the GI programs were written. That was the mentality. Stacking wasn't really necessary because all that you were really trying to do was limit these half a dozen people, and typically even if you stacked you wouldn't get enough GI. Most brokers and producers were prepared to work on the basis that you would get medicals for those few people. There wasn't a lot of pressure there. As people on the COLI market know, the formulas that most people used around GI was that there was $15,000 to $20,000 per life. If you had 50 lives at $20,000, you could get $1 million worth of GI. In order to limit the very senior executives there was normally a multiple, which was that the highest level of coverage couldn't be more then a certain multiple two, three, or four times the average. There were various formulas that people used.

There was also usually a cap on those GI amounts because many carriers just felt uncomfortable even if you applied the formula, if they had 1,000 lives they didn't necessarily want to go out and give $20 million worth of GI or whatever. Normally insurers would have the cap, which was around $2 million. It started off with $1 million and gradually went up to $2 million. That was the total amount of GI that they felt comfortable with. Sometimes it was related to the retention. Sometimes it was just the number that they felt generally comfortable with. There were 10% increases above that and normally there was an ultimate, which was about $4–5 million. That's the whole way that the GI programs were set up.

Let's transport ourselves 10 or 15 years into the future. We don't write much group carve-out business any more. Group carve-out business is a very, very small part of the COLI market. Most of the COLI market is now the financing of corporate liability. The purpose of the insurance is no longer to provide life insurance for the executives. Most of the financing is done on an aggregate funded basis, and the beneficiary is the corporation. As a result the executives are not going to participate in the benefits at all and this lessens the selection substantially.

Second, on an aggregate funded basis you can put the same amount of life insurance coverage on every member or you can put the same amount of premium on every member, whereas, before the decisionmakers got a lot more coverage, other decisionmakers get a lot less. They kind of get the same amount as everybody else.

Third, in a lot of these programs you don't necessarily have automated increases because the coverage is not linked to salary. You put those three things together, that the purpose of the benefit is no longer to provide life insurance, the decisionmakers have taken out, it's level across everybody, and there are no increases. That has made people feel a lot more comfortable in terms of offering GI. What you're now seeing as a result of that is that the limits are maybe 20,000 per life. Some people are prepared to go to 40,000 per life. Now on 25 lives you can get $1 million worth of GI. But here's the issue. Companies still feel uncomfortable going beyond the $1–3 million range on the straight application of the formula. Why? Because no underwriter, or no head of any COLI area, wants to walk in with a $5 million claim, and somebody says, "Well, you know, can we contest this? Where was the underwriting?" People would say, "No, we never underwrote this." There is concern over the ultimate level. The way that you get around that is two-fold. You can either get around it through use of reinsurance to reduce the retentions internally, or if you don't get around it that way, then stacking will occur outside in the marketplace, which is really to increase the cap but not to increase the formula per life. I think that most carriers feel relatively comfortable since what you're really doing is underwriting the whole case. You really are prepared to have a situation where you apply the formula per life. What you're really trying to do is limit your maximum overall exposure.

From our standpoint, what we typically do is we look at the overall pace and apply certain ratios and formulas to it. If we cannot absorb it because of our caps, then under those circumstances we would be supportive of stacking if the amount of overall GI coverage got very high relative to the number of participants. We would feel uncomfortable with that multiple. We would probably decline to participate. The brokers have a particular issue with aggregate funded liabilities in GI, which is when you're doing that kind of financing if your GI cap is too low and everybody in the program has to be underwritten.

For the group carve-out program, if your GI limit is too low, you only have to underwrite the top half a dozen people. In an aggregate funded plan, if the GI limit is too low, everybody has to be underwritten. Therefore, the brokers really under those circumstances have a lot more need to go out and do stacking. But our position is that we will underwrite. We will ask the broker if stacking is occurring. We will underwrite the whole case, and we will decline to participate if we think that the limit is too high.

Mr. Glew: I have a question for Gary. With these higher GI limits, GI is more expensive than simplified issue or underwritten business. Wouldn't buyers be better off actually going through underwriting in general?

Mr. Thomas: I think if they had to they probably wouldn't buy it.

Mr. Glew: Do you agree Chris?

Mr. Parker: I would agree with that. I think it's one thing to ask an executive to sign a form saying, "Yes I agree to be insured." It's something altogether different from telling him that he has to go make an appointment with a physician and to go through tests. I don't know of very many compensation committees or boards that are going to want to tell their executives that this is what they need to do in order to go through this COLI program. It's not a very popular idea, even though the value may be enhanced through underwriting, and it certainly is a little bit more comforting from the carrier's perspective. I think that we're doing everything we can to figure out more broad applications of GI. We're certainly among the guilty parties, or trying to push up those limits to whatever extent possible. We're seeing deals now upwards of $10 million in GI. I don't think that's going to change. I think that trend is going to continue.

Mr. Millwood: Ian, do you think one of the reasons the GI limits have gone up is that it seems as if most carriers' GI experience has been relatively favorable, probably better than their pricing assumptions? It makes them more comfortable that they can offer bigger limits. At some point, presumably if the limits get to be large enough, antiselection will come back into play.

Mr. Glew: Yes, I think that that's right. I think that the experience has been pretty good. I think the experience has been better than most people had expected. However, a lot of that experience developed during a time when GI programs were really quite conservative in comparison to what is happening today. It's not altogether clear to me whether or not we will see a continuation of that experience.

The other thing is that it doesn't take too many death plans at $10 million to ruin your experience for many, many years. I think that we may even find some carriers who are willing to take those kinds of GI limits exiting the market, if they are not well-covered because with one death claim under those circumstances related to antiselection could wreck the profitability of the COLI business for several years.

Mr. Geretto: That particular point, given that we're up to $10 million of initial GI, and obviously now when it comes to groups that have a higher than average weighted average age in the group. On the individual side, of course, we grade down when you look at automatic capacity across the board. Do you think it would be feasible, let's say, to put on the table to have some type of grading down to the capacity so that you could avoid those rather large claims? Let's say for the purposes of discussion, from 40 to 50 you could get up to $10 million. From 50 to 60 you're limited to $7.5 million, from 60 to 65, $5 million and then above 65, let's say down to $3 million. What are your thoughts on that?

Mr. Glew: To some extent that's happened already. There are a lot of companies, ourselves included, that grade down from age 60, down to almost a linear basis to age 70. I think that companies, when they underwrite these programs, do look at the average ages, and are more inclined to give higher GI if the average age is lower. The GI underwriting process, if you have an underwriter who's experienced in GI, is not a formula-driven thing. Our underwriter in particular will comment a lot around the older ages and the level of coverage for the older ages. Certainly over age 60, we customize our GI offers very much dependent upon the demographics of the group. I haven't as yet seen anybody publish GI limits that are differentiated by age. It certainly wouldn't surprise me to see that happening in the future. I think a lot of companies stay away from publishing their GI programs because nobody really likes to be too tied down to that. You don't see a lot. But I think that age is taken into account in many cases.

Mr. Thomas: I think one other thing is that the companies that buy COLI are not really looking to insure their older employees anyway. There's a smaller number of them. When they buy COLI they're buying it for the expressed purpose of having a long-term investment over which they can spread a lot of those up-front charges. It's very common for us to see companies that buy COLI and maybe only buy it on lives under age 55 or 60 at the most. You don't really get that issue with older lives.

Mr. Parker: That gets back to the earlier comment about aggregate funding. If you're going to do aggregate funding, where you're not really matching up the liabilities of one particular executive with whom you're insuring, then it makes a lot of sense to design the program system to maybe only insure people less than 55.

From the Floor: Have you done trending by group sizes from your claims experience? Where is your best claims experience that you're getting?

Mr. Glew: We have not done anything along those lines, even though we have a fairly large GI population and pool. In many areas it is not that credible. It doesn't have the level of credibility that I think would allow us to draw too many conclusions. We really typically limited our experience studies to the more traditional studies of just experiencing it by blocks of ages and a cross-section of underwriting classifications of one sort or another. But we do not have any experience along the lines that you're asking about.

Mr. Thomas: The actively at-work criteria is very important. We were involved in one case where that was sort of waived. The experience was particularly bad. The other thing we found is that if you go in and you cover a group of actively at-work employees, as well as retirees, a lot of times the retirees will have much worse mortality experience than the employees. Is that your experience Ian?

Mr. Glew: Yes, it is. If you're not cautious about what happens at retirement, you can have a real problem there. It's really only a problem on group carve-out programs, because in aggregate funded programs there really is no change at all at retirement time because the corporation is buying the policy. The retirement is not an event. But on the group carve-out side, you have to be particularly careful, because many programs are set up such that the policy is effectively rolled out to the executive. The executive at that point can either elect to continue the policy or elect to cash the policy in. If you don't set up your programs such that there is enough money to make the policy fully paid up at that point, if the executive has to put money into the product, many executives who are healthy won't continue to fund that policy and they will allow that policy to lapse, which means that the mortality experience on the people who do continue the policies would be worse than you would expect it to be. You see that in particular on voluntary group universal life programs, which are not fully funded programs. When you set up a group carve-out program, the wager would take your postretirement mortality experience to make sure that it's fully funded at that particular point in time. Most of the programs are and as a result you don't see quite the change in postretirement and postmortality that you would otherwise expect. But you still see it. There is still some of that ongoing kind of lapse selection that occurs.

Mr. Millwood: We can move on to the illustration topic, Chris.

Mr. Parker: I wanted to address the complexity of illustrations for a minute and see what your reactions are. It was probably late 1988, early 1989 when I rotated into a COLI unit of a major carrier. My boss handed me a copy of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). She told me read it, learn it, and understand it. I'm sad to report ten years later I'm still working on that project. I only bring that up because I know I'm not alone. What we're seeing at Clark/Bardes, is a lot of regulation-driven issues to the point where it's beginning to affect sales. We have 7702 now for quite a while. We have TAMRA, and we have the advent of variable illustrations. In the 1990s we have DSCC and NESD rules and the latest and greatest from the NAIC. All of this is impacting illustrations and the ability to illustrate. What we're seeing is that a lot of carriers are guilty really of not addressing these issues very well. It's beginning to affect who we would work with on any particular case, which I think is really a sad state of affairs. But it's certainly something that we're noticing.

What I see as a trend going forward is that those companies that invest the resources and time and address their ability to illustrate and administer COLI products will definitely have an advantage for themselves. We're cleaning up a lot of messes now spending a tremendous amount of resources trying to deal with all of the uncertainties of the various regulations. I think that going forward we're going to be naive to assume that regulation is going to stop because I certainly think it's going to increase. There's no reason to believe that either Congress or anybody else is going to be kind to us going forward. My point is really to invest whatever you can and to make sure that you have the ability to administer and illustrate the various regulations that are happening right now.

Second, we're seeing the complexity of illustrations increasing because of both client- and consultant-driven issues. We're seeing that clients are becoming more sophisticated. A lot of CFOs now have had exposure to COLI. They've worked with it for a long period of time, and they want to understand a lot more about what they have and what they will buy in the future. We're seeing a lot of situations where either consultant Request for Proposals (RFPs), or even the client directly is asking for increased accounting reports. They want to understand the various pieces and parts of the illustrations whether that be the premium tack, the back tack, the cost of insurance, or whatever. All that they want is to see it laid out piece by piece with full disclosure. Once again, those carriers that are able to address those issues seem to have an advantage. Again, it seems worthwhile to invest in the ability to illustrate that or at least have that ability available on request. We're certainly seeing a lot of it, and I don't think it's going to get any simpler.

Third, part of the complexity is driven by the brokers themselves because the brokers are looking for ways to distinguish themselves. COLI is becoming more popular and more companies are getting into it. Certainly more and more brokers are dabbling in it. Agents that used to do estate planning now think they want to move up a step and get into the COLI sales. What we're having to do, and I'm sure that many of our competitors are as well, is look for ways to distinguish ourselves. As we look for ways to distinguish ourselves the ideas get more complex and the illustrations are getting more complex. It's really presenting a big challenge for both the insurance companies and ourselves to illustrate the designs that we're coming up with. Again, I see that trend continuing. I don't think that just dealing with the flow is going to make it. I think we have to figure out a way to distinguish ourselves if you're a broker, which means you have to figure out ways to show the product that you want to present to the client. Those companies that are willing to invest in the ability to illustrate are certainly going to come out ahead in the long run.

Mr. Gregory William Chicares: Do you see a trend away from vendor-provided illustration systems and back toward things that are done inside the companies to attain this flexibility and marketplace distinction?

Mr. Parker: I think that's a good question because we're seeing almost two conflicting trends. What I was going to address later on is the fact that we're definitely seeing certain vendors distinguishing themselves in their ability to illustrate and their ability for third-party administrators to administrate some of the designs. We're definitely seeing a movement toward that. But at the same time, and as the world rapidly changes, we're always a few steps ahead it seems of what the vendors are able to provide through the illustration systems. The illustration system vendors are certainly getting better and more complex, and they're investing a lot of time. They're light years ahead of where they were even five years ago. But whether or not they can keep up remains to be seen. I'm not so sure they can. It's going to be a challenge.

Mr. Glew: One additional comment I would just make here on illustrations, which I find of interest. With the complex plan designs that are coming up, the closer that you can fit your death benefit patent to the optimum death benefit patent the more performance you can get out of the contract essentially. You find that you can actually get more performance by working with your illustration system to come up with the optimum death benefit patent than you frequently can get by fine-tuning the pricing parameters within the product because the way, as I'm sure that Chris will endorse, that people typically evaluate COLI products is they look at early mid-term and long-term values. The early values are effectively driven just generally by what your commission charge-back procedures are, and what your loads are, and what your up-front expenses are. Obviously, that doesn't really matter much beyond that. There's just a few things that go into that calculation. But the long term values are driven very much by how much death benefit is in the contract. What you will find with a lot of COLI policies is that they're available both in guideline premium format and cash value accumulation test format. They're available with a variety of different death benefit options. What you need to try to do on the illustration systems is to have something in the illustration system that will essentially select which of the two tests work the best and we'll figure out exactly when it's best, for example, to switch from an increasing option to a level option dependent upon the premium streams and all of those kinds of things. Under those circumstances you can get the extra few basis points of a long-term value. That could be the difference between winning a sale or losing a sale. The way that you illustrate your products on your illustration system is as important as the amount of effort that you actually put into pricing the product.

Mr. Glew: I had a question for Chris. I know we have clients that come to us and say, "Well, we got this illustration from carrier X, Y, Z, we run it through our illustration system basically under the same parameters, our interpretation of the seven pay testing works differently, and we end up having to buy a lot more death benefit and we can't compete." How do you deal with that in the marketplace?

Mr. Parker: Yes, I never realized how many different interpretations of seven pay testing that were until I came to Clark/Bardes, and got exposure to anywhere from 40 to 50 different insurance companies. It's definitely a challenge. We're dedicating people almost full time now to studying the various interpretations by the carriers. It's certainly in your best interest to invest some time in that to understand it. Simple seven pay testing is what we're seeing a lot of times and that just doesn't work. If it's only going to work in the first seven years, it doesn't do us a whole lot of good. We were constantly with carriers trying to understand the best way to illustrate seven pay testing. Pushing the limits of the law and those companies that can show that or at least understand it well enough to work with us on a daily basis certainly have an advantage.

Mr. Glew: You talked about illustrations, I guess one of the things we see as being really important in the marketplace is good reillustration capabilities.

Mr. Parker: Yes, we have a whole unit that's dedicated to reillustration as I'm sure a lot of our competitors do. We are investing a lot of money, a lot of resources, and increasing the technology of our systems as is a lot of our competitors. I think what we're finding is that we, meaning brokers, are probably as good as anyone in terms of reillustration capabilities because of how much money we've invested in that process. There's certainly a lot to be said about the amount of time that is spent trying to work out the bugs after the fact. That's the way salespeople are. They go out and sell a concept and those of us in the home offices are left to clean up the mess. If you have any abilities at all to have a flexible system and work with the carriers on a daily basis, that's something that we definitely spend a lot of time on.

Mr. Glew: Gary, how important, working for the buyer, is it for the buyer to see historically what the results have been? A lot of times they get the illustration and they get these reillustrations. At some point do they want to reconcile or this is what I bought? This is what's actually happened. Why are they different?

Mr. Thomas: We rarely do that for our clients. We tend to focus more on how things are projected into the future because basically they're asking us to help them make a decision as to whether to keep the insurance, or surrender it, or maybe restructure it in some way. We don't really get too concerned about looking back into what has happened in the past. I know that we're not that close to the illustration systems and most carriers. We tend to say, put your best foot forward, give us your illustration, and we'll evaluate the product based on that. In the case of the largest types of COLI and BOLI in which the illustrations are generally fairly straightforward, they're structured as maybe single pay or seven pay. You don't have a lot of withdrawals, loans, and things like that being illustrated. It's fairly simple for the carrier to illustrate that. With the smaller types of arrangements where the COLI is being used to fund some type of Supplemental Executive Retirement Plan or deferred compensation arrangement, we have a lot more difficulty getting clean illustrations from carriers. In a lot of cases, we have our own illustration system which we can use to calibrate to different types of products. We'll get a basic illustration from a carrier and then we'll work with our own software from there. It’s often too difficult to go back and forth to the carriers.

Mr. Millwood: Maybe we can go on to the administrative side of things and Chris.

Mr. Parker: We're definitely seeing an increased trend again toward third-party administration. I think what is happening in a lot of cases is that insurance companies have decided they want to make a conscious effort to get into the COLI marketplace. They more or less just lent their surplus for the whole process. They're getting somebody's firm, maybe even Tim's firm for instance, to design the product. They're then finding a third-party administer, and they're hiring an outside vendor to do all the illustration work. They just kind of sit back and let everything work by itself from their perspective.

I think that that's an interesting trend, because what I see happening is that we're going to see another split in the market. Those carriers that are able to spend the money to invest in the administration of COLI designs are probably going to stick with it. At some point if you don't spend enough money, or if you don't hire a third-party administrator, you're just not going to be able to keep up with the ongoing needs. Because again, the needs are growing more complex. We're seeing lots of clients wanting specialized accounting reports. They want their own format for illustrations and it's getting to be a process that is very time-consuming. If you can find a third-party administrator to do that work for you it may be something worth looking at because those that can do it well are probably going to make a lot of money. We've known a lot of companies that have tried to get into third-party administration that haven't done it very well and have gotten out. I definitely don't see a lot of competition there right now. It's something that if you can find the right niche and be good at it, you're going to be successful.

As I mentioned earlier, brokers are certainly investing a lot in administration systems. I know some of our competitors are spending millions of dollars right now. Again, I see that same sort of trend continuing on the brokerage side. Those who are investing in it are certainly going to survive and they're going to do well. Those who can't or don't want to are going to have a tough time I think going forward. I guess that's really all I had to say.

Mr. Millwood: What are your thoughts Ian on trying to administer COLI products in house versus an outside TPA?

Mr. Glew: Because we've been in the COLI business for a long time, we got into the COLI business before there were any vendor-based systems and third-party organizations that would do it. We have always done our administration in house. However, that doesn't mean to say that we've developed all our own software in house. A lot of the software that we use on the administration side is now vendor-based software, but we do the administration inside. I think it's easy when you get into the COLI business to underestimate the complexity of administering COLI policies. It is not just a matter of taking your retail systems and putting some group processing and maybe some listable functions on the front end. It goes way beyond that.

One of the reasons why it goes way beyond that is there is a renewal process that you need to go over on the COLI side that is almost like the process that you go through on the pension side. You need to be able to reillustrate all the policies on some kind of a composite basis. Typically you need to be able to run it through an in-force illustration system. You need to be able to specify for that particular case what the design is and what the death benefit patents are going to be. That means you have to hold case level data, which you don't hold over on the retail side. To take your retail system and convert it over to a COLI system is a very difficult process. Certainly anybody who is not, given the COLI market, I would advise you that is not the way to go. If you're getting into the COLI business the way to go is to have a look at the vendor-based systems that were developed around the COLI business. Many of them actually had the reillustration process as really the center of their business. Everything feeds into the illustration system. The center of the business is not the policy administration. The center of the business is the reillustration system. Then you start to get the service capabilities, which is what Chris is referring to, which is important being in the marketplace. But it is easy to underestimate the level of complexity that is needed.

There is an enormous amount of customization that goes on in COLI business. If somebody walks in and a broker or a client comes to you and offers you $100 million of premium, but says, "I don't want this particular policy to run the way that in fact, all your other policies and cases are run. I wanted to have these particular differences to it, typically you don't say to them, "Sorry, that doesn't fit into our system. We can't do that." Typically you will say, "That's fine, we will accommodate you." That becomes a variation and you'll end up with all sorts of variations. Your systems need to be flexible enough to be able to handle that.

Mr. Parker: Yes, I think we have some new challenges coming through because of the variable life sales that have been occurring. Now there's a demand for almost on-line valuations of the assets. Again, certain companies are investing the money to try to do that. We're seeing a growing need for that all the time.

Mr. Millwood: I have one last question for each of the panelists. I guess as Ian said, there seems to be more and more carriers entering the COLI marketplace. The barriers to getting in are probably smaller now. How do you differentiate yourself from your competitors? What do you have to do? Ian, could you talk about from the carrier side? Chris, from the broker side? Gary, from the buyer side? What do you each look for in a carrier or in a COLI program?

Mr. Glew: For each company it's going to be different, so I would respond to that question in general terms. That is, when you enter the COLI market you should be entering it because you believe you have some kind of a core competency that would allow you to compete effectively. Most people who are in the COLI market are strong in the retail markets. I'm not aware really of anybody who is just writing COLI business and never had a retail side. Essentially, you develop some core competencies. I think it's important when you move into the COLI market to build your COLI marketing strategy around those core competencies whatever they may be. They may be product, they may be service, they may be distribution, they may be branding, whatever it is, build it around that. Then you stand a better chance of succeeding. If you go out and just simply try to compete on other peoples territories, I'm not sure that that would be the best way to succeed.

Mr. Parker: I think the way that we're trying to distinguish ourselves is really more through innovative ideas than anything else. Most of the ideas are coming from marketing and their salespeople. We're finding, as I said earlier, that there's a lot of competition now in COLI, and it's certainly growing. The only way to really distinguish ourselves is to spend a lot of time on research and development and to invest in new ideas, new concepts, invest in our systems, and try to distinguish ourselves through new and patented ideas.

Mr. Millwood: How do you decide which carriers you want to deal with? There are so many out there now.

Mr. Parker: Yes, we certainly have some long relationships. They're going to continue, but in terms of who we're willing to work with going forward I think it's going to be those companies that probably have fairly strong ratings. Ratings are certainly a big part of the game. We need to have companies again that can deal with the administration and the illustration issues that we have. If you're thinking about getting into the COLI business, one thing that will definitely help you, if you're a carrier, is to have a dedicated COLI unit. Those companies that do not have a dedicated COLI unit certainly do not provide the level of service that we're looking for. Those that do have a head marketing person, probably an actuary dedicated to COLI, and some support staffs, are the ones that really excel, and the ones that we find that we get along with the best going forward. We're going to continue to work with that type of a company.

Mr. Gorter: Two questions. First, does a joint and survivor product have any place in the COLI market? Second, if your company is just entering this market, how long does it take to really get a critical mass where you start making profits or something like that?

Mr. Parker: I can address the first part of that question in terms of the joint and survivor. I think that we've dabbled a little bit in joint and survivor as have our competitors. It hasn't really made a big mark yet. Not to say that it won't in the future. You're going to have to explore the opportunities that come available to you. One thing that's going to put a damper on that however, is the 1997 legislation that has the interest disallowance with the exception of certain groups.

Unfortunately, a joint and survivor policy doesn't fall within that exception. Depending on the companies debt perspective that may or may not be attractive.

Mr. Glew: Yes, I would agree with that. We had joint and survivor variations of some of our products and I think they haven't really been a big seller. One of the things that you find when you're in the COLI business is that people come to you for product that are not really COLI applicants. People come to you for product because they want low, low, high early cash value products. Many of them are individuals, and they're buying it for estate planning purposes. That's where some of the driving motivation comes from—from joint and last survivor products rather then the COLI market itself. I don't see the joint and survivor product being on the pure COLI side.

With regard to critical mass, that's not an easy question to answer because it depends on how you decide to do it. I think that you can get into the COLI market using outside vendors on a relatively low up-front initial development cost basis; therefore, you really don't need that much critical mass to get into the business. But I believe that there is a downside risk to doing that which is that as you start putting more and more business on the books, you're actually going to find that you don't enjoy the economies of scale that you would otherwise enjoy if you did make the up-front investment. You have to decide how you want to do it. You either make the up-front investment—you get lower unit costs, you pay more on the front end, you then have large critical mass, but you get the economies of scale later—or you flip it around. You don't make the up-front investment. You don't get the economies of scale later, but you get your break-even point earlier. That's a matter of financial strategy that I think will depend upon who you are as an organization and where you want to be.

Mr. Thomas: Yes, I guess I would kind of agree in that I think one of the critical things that we look at, and I'm sure some of the other consulting firms and brokers look at, too, is does the carrier have a commitment to the market? There are some carriers that have been in this a long time. They have a pretty broad base of COLI, they built a lot of expertise, and they have a lot of systems. But on the other hand, there have been some carriers that have just come from nowhere in this market in the last two years by focusing on a very specific niche. The BOLIs happen to have been that niche in the last couple of years.

But again, if BOLI starts to go away I don't know what other types of COLI this company is going to sell and other companies in that position. I think it goes beyond just having a product. If you really do need to have a specialized COLI unit with expertise, you have to be able to illustrate. You have to at least show that you have the ability to administer the case. I think with the larger COLI products, things like tax, legal, accounting issues, much larger then they do with smaller types of cases, companies are much more interested in how the product is being accounted for, particularly with the stable value products. They're very interested in some of the legal issues.

Tim mentioned earlier the issue of transfer of risk. Insurable interest is another risk that companies have to look at. They're looking to the proposing carrier to see whether that carrier has any expertise or knowledge or anything to offer there too. I think the commitment is a really large part of that. Generally when consultants, brokers, and companies put out RFPs for COLI business, the RFPs are very involved and I always imagine that it would require an enormous amount of work to respond to them. You can see some of them have been very well put together. They've been very well thought through. In many cases, the carriers are able to do that because they've done it tens and hundreds of times in the past. Whereas, the other carriers that are just kind of getting into that type of business are having a much harder time feeling their way through and trying to figure out what's important and what they can skimp on.

From the Floor: I would like to know if there is no tax advantage in one area, how can we sell the idea of COLI and BOLI overseas?

Mr. Parker: I'm not sure I have a good answer for you to be honest. We have come up with some ideas that really didn't rely a whole lot upon the tax advantages. It was more from a pure timing of cash flows perspective. For instance, if you have a particular corporation or a type of industry that has a need for corporate cash flows that are in a particular time frame, say 30, 40, or 50 years from now, there are those types of industries. We've developed some products, or at least considered some products, that would address that type of need through the death benefits by coming up with some unique designs. But without any other experience in the international markets I'm not sure what else I can tell you.

Mr. Glew: One of the things that I think has happened with COLI is sometimes because it is so advantageous in one area, you tend to ignore some of the other benefits that COLI has. COLI policies provide a death benefit. You can structure your programs to have the death benefits that are regarded as being very valuable to the participants in the program. In that way, you can basically make it much more advantageous to buy a life insurance policy to finance both the pay out benefits and the death benefits than buying a nonlife insurance investment to do the payout pieces, and in separate term insurance to do the other. That's the one aspect.

The second aspect that people use COLI policies for is that there are some death benefits where the distribution of the payout is close to the distribution of death.

For example, for most people for postretirement health care 50% of the money that is spent on health care is spent in the last 6 months of their lives. If you are providing postretirement health care, life insurance is one of the very best ways to provide cash flow from a timing standpoint at the time when it's most needed. There is no other investment that does that. Those are just a couple of examples of ways in which COLI policies can be used. It's outside of the tax advantages, and almost definitely would apply in all markets in respect to whether there were tax benefits or not.

Mr. Glew: I think that there are two different aspects of BOLI. One is that a number of banks buy BOLI because they're COLI policies. In other words, they buy them for exactly the same reasons as to why any other corporation would buy them. They have deferred compensation liability, because they have postretirement, death benefit liabilities. They have executive benefits that they need to provide COLI policies. If they work with them, they don't buy them because they have access to low-funded capital.

To the extent that people are buying BOLI policies to try in some way or another to take advantage of the difference between the cost of capital and what they can earn inside of the policy, under those circumstances if you remove the tax advantages on this side BOLI would almost definitely go away.