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ASSESSMENT OF TODAY'S MARKETING DISTRIBUTION SYSTEMS

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The major distribution systems are: a) full-time agents, b) brokers, c) personal producing general agents, d) property and casualty insurance agents, e) debit agents and f) mail order.

1. Description of the Systems.

2. Current Market Share and Trends in Market Share.

3. Relative Costs.

4. Differences in Other Aspects of These Distribution Systems, such as Mortality and Persistency.

5. Major Advantages and Disadvantages of these Systems.

6. The Way in Which these Systems Will be Affected by Change.

MR. ROBERT P. HILL: A full-time agency system is characterized by the employment of a career sales force which devotes its principal efforts towards the sales of the products of one company. In some cases, sales through other companies may be completely prohibited, but often there are provisions to allow such sales; for example: to seek a more liberal underwriting classification or to sell a product not offered by the primary company. In a recent LIMRA study that was made, half the full-time ordinary agents reported that they placed all their business with their primary company. In return for the full-time agents' business, the company devotes considerable resources to subsidize new agents and to train agents in product knowledge and sales techniques. There is also considerable home office support for agents, and typically there is a full employee benefit package. This system's greatest strength is its ability to develop large numbers of trained agents. Generally the companies have extensive training programs and sizeable staff to educate both the new and experienced agents. Also, as with full-time salary personnel, loyalty to the company and identification with its goals generally exists in full-time agents. Therefore, this system develops close, cooperative relationships between the home office and the field which are vital to successful marketing. While the association of the agent with one company is viewed as a narrow interest by some, the wide range of products typically offered by such a company along with the increasingly competitive nature of the insurance business minimize this as a negative aspect. The biggest challenge to this mode of operation, the full-time agency sales force, is the high cost of training and developing new agents. There has been an increasing trend for companies to reduce or eliminate their recruiting of untrained sales representatives; and if this trend continues into the future, it obviously will lead to fewer agents and a shrinkage of the total individual life sales made.

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The debit distribution system is in reality a type of full-time career agency system. Debit agents are company employees. Each is assigned a particular territory in which he sells and services debit life and health insurance. The term debit arises from the responsibility that such agents have to collect and account for premiums which are generally paid monthly. Since the agent has collection, accounting, conservation, and other servicing responsibilities, he receives regular service compensation in addition to sales compensation. Often this distribution system is described as a home service distribution system rather than debit. For many companies today what was formerly just a debit distribution system has evolved into what we call a combination system. This refers to the broadening of the agents' products to include ordinary life insurance and often a variety of other lines of business as well. For example, some district agents sell debit and ordinary life and health insurance, group insurance, group annuities, variable annuities, and property & casualty insurance. The compensation base, provided because of the debit agents' service responsibilities, permits new agents to survive in the business. It also provides stability for experienced agents during periods of low sales results. The assignment of a territory to each agent, along with responsibilities to contact policyholders on a regular basis, help to provide the activity and the opportunities for prospecting that are critical to sales success. On the other hand, some feel that the cost of providing such personal home service and the decreasing availability of policyholders in their homes, have made the debit system somewhat less practical today. Some question whether the marketing of very small debit policies should be continued if it cannot be done more economically. However, in lower and lower-middle income markets, this may be the only feasible way to sell individual life insurance and to keep it in force. While critics often say debit insurance is too costly to consumers, most strictly ordinary companies have abandoned this market as being too costly to insurers. Upgrading of markets and higher minimum issue limits have kept the debit home service concept economical. In fact, some offer both debit and monthly ordinary insurance at the same cost, with debit insurance distinguished from ordinary simply by the fact that the agent receives and accounts for the premium rather than having the premium mailed to the home office.

MR. PAUL T. BOURDEAU: Now the script calls for me to go into the property & casualty brokers as well as the independent agents. They mean a lot of different things to different people. But the characteristic of the property & casualty brokers is that this system is developed around the independent property & casualty agents who are basically independent contractors usually representing several insurance companies with freedom to select the insurer for any particular piece of business whether it is life or property casualty. Life insurance is usually not the major thrust of their business. Most of these agents have a strong relationship with one property & casualty insurer known as the primary carrier; and this is usually because of current and past personal relationships and service. It is just not possible for property & casualty brokers to be as proficient as they need to be in property casualty as well as life insurance. Therefore, this distribution system requires considerable help with the technical aspects of life insurance as well as help with the actual sale. Occasionally, a life specialist works within an independent insurance agency, but our statistics show that only 8% of the casualty property agencies have a resident life specialist.

Financial incentives to sell insurance vary considerably in this area. They are generally not as important as the expertise that is provided by the life insurance company or the assistance in sales proposal and sales situations. Surveys indicate that the financial incentives mentioned above are somewhat secondary. The independent contractors have various reasons for which they choose involvement life insurance. It might be money; it might be to protect a customer base; or just simply for professional growth. They just enjoy the life insurance business.

What are the major advantages of this system? Usually there is little financing or training cost, certainly as compared to career and other systems. And much of the costs that are incurred are likely to be incurred when business is placed. Another advantage is the potential for a deep and broad penetration of insurance markets because these brokers are in place disbursed throughout the country and have a customer base with immediate and real access. From a consumer's point of view, an independent agent is attractive because this agent is not required to sell from a product line of only one company but can select the company most advantageous to the buyer. The casualty property brokers are experienced businessmen in many cases and are likely to be around longer than a typical career agent, so that turnover is somewhat lower among this type of agent. And because of the good business relationship the average property casualty broker has with his clients, a relatively quality book of business is written.

There are disadvantages, however. There is an ever increasing intense competition for these agents. Also, a company must be extremely product and price aggressive in order to convince these agents to use their products. These agents require costly technical support as well as costly selling support. They tend to be less loyal. An important point, too, is that these agents tend to react to the company as a whole; and harsh measures as far as availability of casualty property lines can have a negative effect on the sale of life insurance. Life insurance to these brokers is a secondary item; and therefore, the business can be volatile from year to year as they cope with problems with their property casualty lines. Also, innovative approaches to marketing, such as Retired Life Reserves or other items may divert their attention. The average production per producer is quite low. Given such a variety of these brokers -- for instance, personal lines or commercial lines; urban or rural; big or small -- a company has to segment their market in order to rifle in on the type of broker they can realistically service. Operating with these property casualty brokers requires good service, top notch communication, and expertise in merchandising techniques.

With respect to the independent agent, there are many similarities but it is difficult defining the independent agent because there's a fine line between an independent agent and a personal producing agent. As the name indicates, these agents are independent and represent several companies, although they may tend to favor one company. In most cases, these agents started as career agents but because of their markets or their attitudes have outgrown a single company affiliation. They tend to be entrepreneurs and somewhat maverick requiring special handling. They generally do not report through a branch office or general agency. In many cases these independent agents have other interests such as financial planning activities or real estate. We can categorize them as expert with life insurance and individuals who value their independence. For these agents life insurance is not secondary. Trends show these agents looking for more general business guidance, and more computer support; and that they would rather not deal with too many companies.

There are advantages of this system. There is little financing or training cost. There is deep and broad penetration because they are in position throughout the country. They have a customer base that they can reach quite easily. And from a consumer's point of view, they have independence. Their quality of business is quite good and the average size case is usually quite large. These agents generally are not new and are proven, and they tend to survive in the business quite well - although they may not be that loyal to a particular company.

As with the property casualty brokers, once again, you can have the disadvantages of the intense competition for these agents due to the low cost and the pervasiveness. And again, you must be extremely product and price aggressive to gain and keep their loyalty. These agents tend to be less loyal than full-time debit agents. In this distribution system, technical support is required, as in almost all our systems, although the selling support is not required as heavily as with the property casualty brokers. Once again, the business can be unpredictable from year to year. They are generally a more difficult group to manage because of their independence and because they are quite entrepreneurial. You have to segment on this market because your success means meeting their needs and wants, which necessitates effective communication skills and merchandising techniques.

MR. DONALD W. JAMES: We can define the typical PPGA two ways. Definition number one would be a successful producer who wants to build a small organization around him by attracting additional business. He does not really want to go the full career route, but he wants to do more than be an individual producer. He is attracted by management. He may be located in a detached area and does not feel he needs the services provided by his present manager. Hence, it is a way for any company, but especially a career company, to build a foothold in a new territory at relatively low cost. The second definition of the PPGA is very much like the independent agent. That is, a producer whose production level is sufficient to support the producer's independence. He has probably developed a marketing specialty but has no desire to be in management, wants top dollar and compensation but minimum services since he prefers to provide his own. He is willing to give first call on his business to one company, generally in upper-income markets. This differs from brokerage in that this system concentrates on attracting a producer rather than simply obtaining production.

According to LIMRA, figures indicate that most personal producing agents are in the middle-income market. Their production retention is about the same as a typical career company, and most of them move their new business around from company to company quite frequently. I am not suggesting they roll over business in force but one year they produce with one company and another year with another. The first advantages of a PPGA system is the concept of cheaper business, low development costs, fringe benefits, and services. A second advantage is that costs are variable especially for a small company. The company puts in incentive commissions, instead of fixed costs like housing, telephone, clerks and so forth. For a small company costs are kept in line. It is an easy way to get into new markets. A debit company can get into new markets through this system or new geographic territories can be found for career companies. Many of them feel they want to get out from under the old style local sales manager who is seen as not being up to date with new marketing dimensions. We quickly forget the developmental activities of the sales manager, and these agents see themselves as growing beyond their sales manager and want to become personal producing general agents.

The first disadvantage is that this really is not a system. In many companies, it degenerates into paying top dollar for a piece of surplus business. The second disadvantage is that sometimes these agents really are not that independent. They get lonely or inflation hits them and they want more help, so either the company ends up putting in additional costs for service and travel to keep their retention rate up, or else the retention rate goes down as these so-called independent agents drift to another company or back to a local manager who can provide services. And we will see more and more of that as time goes on. Third, sometimes selection is poor. Typically many companies involved in this type of system will get taken by sharp-shooters who pour in a lot of business on an annualized basis, and then roll from company to company. The fourth disadvantage: Autonomy leads to unpredictability in terms of production. You may get only the problem cases. Fifth, is the tendency for companies to get fragmented. The company tries to meet the various needs of all of these new producers and the new producer wants to get away from the old company although quick to point out that his old company did a lot of things right. As a result, the PPGA company if not careful will get fragmented in terms of service. And sometimes there is a conflict with an existing distribution system. Many times a debit company goes into the PPGA business but has the same underwriters working with both systems, and problems result.

The critical factors in making a PPGA system work are that the PPGA cannot be a second class citizen. The underwriting sales and services must be geared to his market and sales style. It is probably a good idea to have specialty products; good selection standards; and a reasonable, but not necessarily top dollar, compensation plan. Self-policing is important in case production drops as is front end financing through annualization; and finally needed is a marketing plan with some clear target definitions. In this type of system the customer of the company is actually the producer rather than a potential insured.

MR. DANIEL J. GROSS: Direct response methods differ from traditional agency methods in three main aspects: how the company communicates with its customers; how it selects its customers; and how it has to modify traditional products to adapt the realities of direct response marketing.

In terms of communication, we are all familiar with the agency system. In that system, the agent selects the policyholder, or potential policyholder, and serves as the policyholder's intermediary between the policyholder and the company. In direct response, the company communicates directly with the potential customer. It uses direct mail, television, telephone, or print advertising to communicate to the customer. And the customer communicates directly back to the company through either telephone or mail. Of the four ways of communicating, companies have found most success thus far with direct mail and television, and not as much success with outgoing telephone or print advertising. And the direct response companies are generally finding more and more importance in some kind of personal contact, so telephone communication from the customer or the company is becoming an increasingly important adjunct to the written word or mail messages which have been the major form of communication.

In terms of selecting the customer, direct response and particularly the direct mail part of direct response afford a great opportunity to choose a target market. And success in direct response and direct mail business is most influenced by proper targeting of markets. The most success generally has come where there has been a target market which consists of close grouping and an endorsement of the company's product. The endorsing group can be a professional association or a trade association, special interest group or fraternal association; or it can be a commercial organization which issues bank credit cards or oil company credit cards or some other commercial organization. The company uses direct mail or other vehicles to communicate to all these people who are pre-selected.

There is another way of selecting people other than in the distribution, and that is by designing special products. Then, choosing media, you can pick out targets. The two most common in life insurance are product design for students who have different pricing characteristics in a student life market, and products designed for senior citizens who also have special characteristics. That is the second way of targeting.

There is a third way of targeting which might be called pseudo-targeting. The product is absolutely normal, and there's nothing special about the marketplace but the advertising makes it special. For example, there are television commercials announcing a special health plan for veterans if they write in for it. Now there is no more need for most veterans for a health plan than the rest of us, but this kind of advertising creates the picture of some targeting and creates a feeling of affinity.

In terms of product design, there is no agent to explain a complex product so the general rule is simplicity. You cannot have special tax benefits; you cannot have very much that is complex. The product has to be advertised and described simply and it has to be sold simply, which generally means a relaxation of underwriting rules. Guaranteed issue is common on health products. Life products will either be on a guaranteed issue basis with a limited benefit rider, or very simple short form non-medical underwriting is used. Medical underwriting has been used successfully but rarely.

A prominent advantage of the system is the lower acquisition cost. Also, you can tailor a product to very significant market segments with this distribution system. And, you can tie the method of payment on a credit card to the method of sale.

Perhaps most importantly in terms of expansion, you can test a product relatively inexpensively, stop selling it if it does not work, or expand it rapidly if it does work.

There are disadvantages. Many consumers want to see an agent. Surveys show 50% of the people would not trust themselves to buy life insurance policies. You also eliminate certain kinds of sales. You cannot sell a high amount policy, a policy which has to be individually tailored, or a policy with major tax benefits through direct response. The direct response companies do best in markets where the agents cannot do as well. The $20,000- or $30,000-a-year person is probably the best target for direct response life insurance.

MR. DONALD R. SONDERGELD: The next topic is Current Market Share and Trends in Market Share.

MR. BOURDEAU: We described the systems; we were not describing agents or companies. For example, an agent could be a PPGA agent with one company and also an independent agent with another company. You cannot define these systems by an agent. Some companies have a PPGA branch. They may have an independent agents division. Any one company may sell through several of these channels.

Market share research has all kinds of problems with differences in reporting and differences in definitions. Nonetheless, we made a good estimate of the current market share, of first year life insurance premium sold through these various systems. We purposely did not refine these numbers beyond the nearest 5% because anything else would have implied accuracy, which we did not have.

Full-time agents comprise 50% of the business today; debit 20%; the property casualty brokers and independent agents together 15%; the PPGA 10%; and direct response, not including association group about 5%. The notable companies in that business make up 2 or 3% of the premium.

We have evaluated the underlying trends in order to estimate what these market shares might look like in mid 1980. Our best guess is that full-time agents will continue to account for about 50% of the sales in the mid 1980's, although the makeup of these full-time agents will be quite different. There is definitely a trend toward the multi-line, exclusive agents who sell both life insurance and property & casualty insurance. The number of full-time agents selling exclusively life insurance will decline and the number of full-time agents selling both life insurance and property & casualty insurance will increase.

The full-time agent is the traditional way of selling life insurance in our business, and in aggregate that will not change. The top 20 companies sell either exclusively with full-time agents or primarily through full-time agents. That will remain so.

Sales of life insurance through debit agents has been declining in the recent past and we expect these declines to continue so that by the mid 1980's the current market share of 20% should be reduced to about 15%. Some of that reduction may be in how they are defined. That definition is changing slowly.

We have not been able to get reliable market shares separately for property casualty brokers and independent agents so we have put these two together. We estimated a current market share of about 15%. By the mid 1980's we see this closer to 20%. There are several trends that indicate an increase of life insurance sales through these systems. More companies emphasize sales through the independent agents and more companies are willing to do a brokerage type business with independent agents. There is some concern on the part of the independent agents and property casualty brokers that they must sell more life insurance to increase their income - and also some concern to protect their customer base from the increasing number of companies that are going multi-line. There are some companies going multi-line, going into commercial line or casualty property that were not in that business originally.

The PPGA market has been increasing to its current level of about 10%. The best estimate is that this market share has peaked and we would expect the market share to remain at about 10% through the mid 1980's. This method of distribution is becoming more expensive and it is experiencing considerable turnover as other PPGA companies are aggressively seeking out the same PPGA's.

The last item is direct response. We can say here that the market trend is showing vitality. There is more innovation, but because it is working off a relatively low base our prediction for the mid 1980's is 5% which is what we had at 1980. It is not today nor will it be soon a major system for the distribution of life insurance.

MR. SONDERGELD: The next topic is Relative Costs.

MR. JAMES: The career agency system is the most expensive to develop but we get more predictability for the long run through exclusivity. The PPGA system is less expensive since we do not have developmental costs. We give up some predictability but with careful selection we can get people who have sound reasons for leaving their present company and avoid those who apparently have unsound reasons for leaving their present company. The brokerage system is less expensive still, since we not only save the cost of development but costs of housing and administration as well simply by providing good products and local service. And finally, the direct mail system is least expensive since we cut out the entire cost of the direct sales force with a relatively inexpensive substitute.

I will quantify the inherent costs of marketing through each system including total home office and field marketing costs for an individual life product including first year commission costs. For many years I have defined an actuary as a person who carries a guess out to seven decimal places. I guess the definition of a marketing man is he just guesses. The exclusive agent system is 135% of first year premium; the PPGA, 12%; the broker, 11%; and direct mail, something under 10%, say, 90% of first year premium in these marketing costs.

There are several things wrong with these assumptions. First, the labels are confusing. Some companies treat so-called preferred brokers like career agents and others treat them like PPGA's. Some so-called career agents are detached from the general agency or branch office under expense allowance agreements that look like PPGA contracts. Brokers demand, and often get, PPGA style contracts for an occasional piece of business. Career companies develop debit agents, health agents, multi-line agents and life only agents. And finally, many PPGA companies would get very upset at people suggesting they do not have career agents. They consider themselves as developing career PPGA's.

Another problem besides the confusing labels, is that most management information systems are not accurate enough to compare actual costs to assumptions made in the product pricing in the same company. The plethora of product lines and sources of business, the allocations between acquisition and maintenance, field and home office, policy premium and volume, and finally the trade-offs between the various elements of cost such as sales, underwriting and claims, make cost comparisons between companies almost impossible.

Third, even if the numbers are reasonable approximations of some inherent costs of the various systems, most companies are considerably less productive than these numbers would suggest. And this is the crux of the problem facing the industries in the 80's no matter what the scenario. Yet, few companies representing each of these systems are producing large quantities of life insurance at costs below those I assumed, and I include the career system. The existence of these extremely effective companies provides an opportunity and also a dilemma for their competitors. The competitors must do something to narrow any existing competitive disadvantage in marketing cost at least to a point at which it no longer has significant impact on product pricing assumptions, sales and profits no matter what their present system is.

There are four slightly different lables for the methods companies are using to obtain new sales. First, they develop exclusive sales people. Second, they convince sales people developed by other companies to make their company their primary carrier. Third, they attract relatively small amounts of production from many different independent sources; and four, they eliminate the face to face sale entirely.

Those labels are similar to the systems we use. As we look at what companies are doing to make their distribution systems more productive, we see that companies are emphasizing the development of exclusive agents selling life and health add property and casualty business. They hope to hold down financing losses and developmental costs as a percentage of total first year premium and improve agent earnings and retention. Second, we see companies emphasizing exclusive agent development, increasing their attempts to convince agents developed by others to switch companies. LIMRA statistics show that there is a very definite increase in the number of so-called classic, career development companies who are increasing their recruiting of experienced agents of other companies. Their hope, of course, is to decrease developmental costs, supervisory, or fixed administrative housing costs while gaining a large amount of production. They also provide large expense allowances for detached agents in order to retain their business. Third, we see companies emphasizing agent independence begin to provide some fringe benefits, a convention, and local services. Their purpose is to improve retention, attract higher amounts of production per outlet, and obtain some degree of loyalty like the companies emphasizing development. We see companies dedicated to attracting production from many sources. The brokerage companies provide more local services or higher compensation in order to get more business per producer and spread overhead over a bigger base. And finally, companies which do not use face to face selling are starting to use some sales followup on leads to increase their production.

Many of these changes seem to be nothing more than borrowing from a different system to bolster the current one and hopefully to bring it more in line with the distribution costs necessary to compete in the marketplace. One result is a blurring of the distinctions between the systems. More importantly, many company attempts to borrow another system often fail miserably. The negative effect is that life agents do not sell enough property & casualty business per agent to cover start-up costs except in very large companies. Most companies do not have enough agents to sell the quantity of property & casualty business necessary to get the advantages of a big company.

Agents recruited from other companies have no better retention than inexperienced agents in many companies. Or the big producers demand so much in bonuses and expense allowance and service that any perceived cost savings totally disappear. Companies giving PPGA services or benefits on top of the contract may find that they have eliminated any inherent cost advantage in the system, especially if, as the LIMRA figures show, production is only average. Brokerage companies fail to get any advantage from extra services because they pay double sales compensation on virtually every sale. And sometimes direct mail companies find that outside a narrow affinity group or narrow base of products, the response rate drops so low that their cost advantage disappears.

Too many companies have learned to their dismay that trying to correct a problem of high distribution costs by borrowing some perceived tactical advantage of another system may simply cause more problems. The marketplace is logical and not irrational. There is a logical relationship between the needs of the consumer, the services offered, and the means by which the services are offered. One distribution system may have inherent advantages over another only when it is operating in its market segment with appropriate products and with effective management. The changes which borrow a perceived inherent advantage of another system simply will not work.

In the 80's all three scenarios suggest a future in which inefficiencies relative to other companies will not be tolerated. Consumers may not learn the differences in companies but sales people will. They will create an intense competitive situation in price, product, services and compensation, and only the strongest companies combining a cleverly and clearly defined marketing strategy with extremely tough-minded operating management will prosper.

MR. HILL: I will discuss the difference between the various distribution systems in terms of commissions, persistency, mortality, and premiums. Starting with direct response, in terms of commissions, there is no agent commission but organizations endorsing such solicitations or sales campaigns may receive fees. In regard to systems involving agents, typical ordinary life commissions on first year premiums are as follows. For full-time agents, 50 or 55% in New York and 60 or 65% outside New York. For brokers, companies operating in New York generally pay about 55% in first year commissions. Companies not operating in New York would be in the 60 to 70% range. PPGA would be given 60% in New York, 80 to 90% outside New York.

Distribution System	Companies Operating In New York	Companies Not Operating in New York
Full-Time	50 or 55%	60 or 65%
Brokers	55%	60-70%
PPGA	60%	80-90%

Commissions on debit life insurance may be 50 to 55% of premiums in New York. In some cases they may be based on a multiple of the net increase in collected premiums.

In renewal years, it is typical for brokers to receive level invested commissions such as 5% annually for nine years. In the case of full-time career agents, the renewals are typically heaped towards the earlier years: For example, they may receive 10% for two years and 5% for five years followed by 2% service commissions. PPGA's also receive heaped renewals plus fees of 2% or 3% a year. For debit business, a collection commission of about 7% of renewal premiums per year is paid.

A complete comparison of agent compensation would encompass security benefits, expense allowances, training allowances for new agents, and various elements of sales support, training and housing. The total compensation packages offered by the various systems must have relatively similar values since these systems are in a competitive equilibrium.

Persistency and mortality results vary under these various systems, but it is questionable whether any differences in experience are the result of the distribution systems themselves. For example, it has been shown that lapse rates are related to income, age, mode of premium payment, and plan of insurance. There would not necessarily be any direct relationship between the various distribution systems and these factors. Sales made through any of these distribution systems to middle aged, higher-income people who will pay annual premiums will have better persistency than sales made through any of the systems to younger, lower-income people who are going to pay on a monthly basis. Of course, it is a fact that the various distribution systems tend to be utilized and sell in different markets. But it is the differences in the markets rather than the distribution systems that produce any variation in persistency or in mortality results.

LIMRA regularly publishes lapse rates, but they do not provide many details in terms of distribution systems. Recent experience has shown that sales not surviving the first thirteen policy months, averaged 15.5% for the 68 reporting companies or departments with a range of results from 8% to 28% among those 68 companies. Results for 10 reporting combination companies range from 18% to 50% with an average of 40%. While the difference between ordinary and combination agent persistency seems quite large, "Studies have consistently shown that most of this difference disappears when recognition is given to differences in mode of premium payment and differences in income of the insured," as reported last year by the industry advisory committee on policy lapsation.

One aspect of the various distribution systems that does relate to persistency is the degree of policyholder service provided. At one extreme, the debit system involves regular home service and produces better persistency than expected. The other extreme, the direct response operation has no provision for personal contact to conserve policies. Therefore, it is critical that direct response focus on markets which have good persistency records.

There are few statistics regarding industry-wide direct response persistency. One company has published an overall lapse rate of 6% per year. At the other extreme, another company reports first year lapses of 32% grading down to 6% by the 20th year. As with ordinary companies, there is a great variation in persistency experience with direct response, probably the result of variations in markets. Differences in mortality results are dependent upon the market served and the degree of risk selection in the underwriting. A company that emphasizes good field underwriting and selection of risk by its agents is likely to achieve better mortality results. However, the underlying mortality experience of the market sought by the distribution system will be the most important determinant of mortality experience.

Among the distribution systems the most prominent mortality difference would occur with direct response business. Since there is minimal selection of risk, the mortality results are expected to be higher than fully underwritten standard business produced by an agency distribution system. There are no available intercompany studies of direct response mortality. Furthermore, they would not be very meaningful since the mortality results will vary with each sales effort and would depend on the insurer's ability to target the market correctly and enroll a healthy group.

The combined effects of the differences in expenses, persistency and mortality are reflected in the premiums and the net cost for life insurance sold through the various distribution systems. The direct response approach attempts to produce lower cost by eliminating the expense of an agency distribution system. And in some cases the cost of direct response in insurance is very competitive. But it is hard to sell insurance without an agent explaining the various policies available and reviewing the individual's needs.

Another approach to lower net costs is through the use of a distribution system developed by other companies -- that is, to utilize brokerage. While such a distribution system can produce lower costs, it is detrimental to our business if companies decide to cut down or eliminate the recruiting and development of an agency sales force.

MR. SONDERGELD: How will these distribution systems be affected by the high inflation scenario, the incentive and investment scenario, and the social democracy scenario.

MR. HILL: The one overwhelming factor in these scenarios as they relate to the full-time ordinary and combination distribution systems is inflation. The continuation of double digit inflation for seven years as envisioned in Scenario A is the key factor in comparing it to Scenarios B and C which assume a decrease of 5%.

In an ACLI survey published last year, 38% of those questioned felt that the family man should buy more insurance during an inflationary period while only 12% said the family man should buy less. Inflation has increased rapidly, and although the public is buying insurance, it is increasingly turning towards term coverage.

Under Scenario A, most life insurance sold would be term and renewable over short periods. Continuing double digit inflation would mean that few people would be willing to set aside dollars for future delivery except in investments which they expect to grow with inflation. In this environment, it would continue to be sold, probably with provisions to provide increases with inflation. Regulations would be loosened to permit unit-linked permanent policies involving investments in everything from equities and real estate to gold and coins. But even in this situation, competition with existing investment outlets would produce relatively low commissions. The bottom line is that the first year commissions from permanent insurance, now utilized to fuel our traditional full-time career agency system, would not be there in Scenario A.

Many presently successful life insurance agents would survive in this environment, but those who are not flexible would not.

Expense pressures and difficulties in selling permanent insurance would lead to great reductions in the number of new life insurance agents hired. There would be a significant reduction in the total number of life insurance agents. Those who survive would do so by broadening the services they provide. Many would become financial advisors. Under this scenario, people would be anxious for financial advice, and life insurance agents would be available to provide it. The successful agents of the future will broaden their knowledge and offer wide ranging products and services, often being compensated on a fee basis. Their goal will be to handle a client's total finances by providing investment services, including money market funds with check writing services.

This will be accomplished through greater cooperation between agents and other professionals. Through a pooling of talents, rather than the traditional single agent approach, a team will provide competent wide ranging services. Future field operations are likely to be consolidated into fewer but larger agencies. These trends will result in greater automation, the handling of a greater number of clients per agency member, and therefore, economies of scale.

Another "anchor to the windward" which many life agents would utilize to survive in an extremely high inflationary environment would be property & casualty insurance. Fixed life insurance renewals and service commissions rapidly lose value when there is high inflation. There would be high lapses too. But automobile and homeowners premiums and commissions go up with inflation, and these coverages are essential. The latest LIMRA data shows that 32% of the responding life agents sell property & casualty business in comparison to 26% two years ago.

Scenario C is an anti-business environment, but with inflation at 5% it is one in which the business can at least survive if not thrive. Permanent fixed dollar products would be salable.

Government programs would provide tough competition. As in Scenario A, national health insurance would eliminate a significant source of income for many life insurance agents. The so-called National Pension Corporation would attract most small pension plan dollars. Furthermore, the apparent increase in social security benefits would cut into private insurance needs and the ability to pay premiums. The return to "voluntary simplicity" as a dominant social value would be helpful in Scenario C. Conspicuous consumption has attracted dollars away from savings and life insurance sales, so the return to simple values would be favorable to our business.

Scenario B represents the return to the "good old days," and may be even better. An inflation rate of 5% and a return to rugged individualism would mean that permanent insurance would be salable. The permission to provide banking services would lead many agents to become money managers or financial consultants for their clients.

Apart from the scenarios, the 80's will offer many opportunities. There will be 18 million more people employed by the end of the decade, and a 25% increase in the prime life insurance purchasing age group which is 25 to 44. The full-time agency distribution system provides convenient personal services through individuals who are trusted and respected by those whom they serve. While the products and services they offer in the future may change, the basic strengths of the agency system will guarantee its continued vitality.

MR. BOURDEAU: A marketing situation involves five items. There is a customer base, the needs of the customer, the distribution system, catalysts to make the sale, and the product. We tend to think solely about the product without remembering that there are four other items. Successes in any business are strong in at least one of these areas. Either they have a solid customer base, or an advantage in their distribution system, or a product superiority. They have a distinctive competency. They know what that is and they concentrate on it. They have developed a superiority and they are going to work around that. To start a new distribution system is not easy. Perhaps they try a few new products through it, or expand the customer base, or try a new merchandising technique. The job of the marketer is to take his strength and then expand the others one at a time. That is the way we will change. We will retain our distribution systems. We will make them more efficient and manage them better. We will expand the customer base and the product line. We will improve our merchandising techniques. We will use tax law changes to our advantage in the market.

Under the momentum scenario, the property & casualty brokers will continue to thrive somewhat in their environment, because inflation will raise the cost of their property casualty insurance and they will enjoy higher commissions. National health insurance and increases in social insurance programs will have an adverse effect on most distribution systems -- expecially those relating to the lower incomes. The independent agents and brokers tend to do considerable group insurance as well as accident and health insurance and would be affected by national health insurance.

The common denominators of these distribution systems is that they are tied into small businesses. One can estimate the future of these systems by looking at the small business climate. In the momentum scenario, the small business will have its problems. So these businesses will need good advice as well as tax and estate planning advantages provided by life insurance.

Entitlement consciousness would lead to more social insurance and security programs. There would be a degeneration of entrepreneurship which would mean fewer small businesses.

Under the incentive and investment scenario, small business would be encouraged and independent agents and property casualty brokers would do quite well themselves. Competition would be encouraged and more individuals would be likely to enter the ranks of independent agents or property brokers. Rugged individualism would provide more need for insurance and would enhance our careers in business.

The social democracy scenario would result in a trend away from entrepreneurship and independence that would be very damaging to businesses and the distribution systems that work with these businesses. The individual's desire for independence and entrepreneurship would suffer and fewer young individuals would opt for a career as businessmen or independent agents or property casualty brokers.

MR. JAMES: There are forces within our industry that are trying to change us into some other industry -- a financial services industry -- and if that change emerges there will be tremendous problems in companies, especially in "one product," "one distribution system" companies. The emergence or non-emergence of a new industry called financial services should be monitored and we should try to determine the degree to which financial services will emerge. It is in that kind of an environment in which other distribution systems will either combine with or compete with the distribution system already in place. That includes stock brokerage offices, real estate sales offices, legal/accounting firms, tax preparation services, finance companies, and personnel departments of large companies.

Another major factor that has been underestimated is the distribution system itself. The "system" is people, and they are going to survive. There is a massive force ready to shape the future of our companies, and that is people, already in the system with their desire for professionalism and independence and their knowledge about the products. The agents understand the product and they are getting better at it. They have to compete with one another to make money. They are mobile and they are going to align themselves with companies that have strong marketing areas. There is going to be chaos in the industry over the next five years as agents and management shift companies. They may stay with a company and give them whatever business they need to keep their nonvested renewals, but they are going to move.

The scenarios will have different effects on these major elements within our industry. The momentum scenario will hasten agent independence. The big general agents will make it. The good agents will demand top dollar. They will make certain that no system has any advantage over any other by moving business and demanding services and money. Agent firms will begin to bring in junior partners. Development will occur within the agency system rather than at the agency level and many companies will disappear.

In the incentive and investment scenario, the financial service industry will never get going because it will be "every man for himself." Carrying it to the extreme, the individual producers will take on more power and pull themselves away from companies. Under the incentive and investment scenario, we would see the forces related to the financial services industry being allowed to move ahead rapidly. We would see many companies, not just insurance companies, able to stay ahead of the agents. We would see a new concept of a career agent. He might be a financial planner; he might be a multiple line property casualty agent; but he would be a company person because the companies would be able to stay ahead of the distribution system and put together a marketing package that would make sense.

Under both scenarios, we would see more fees, although not a tremendous increase. Under the first scenario the fees will go to the agent. Under the second scenario the fees will go the companies. The company will use those fees and other sources of income to maintain their control over the distribution system. The critical factor will be the field management talent. Trying to run a multiple financial services detached branch office will be difficult. Companies will need a new marketing manager, not the old time sales manager, and a lot of companies will not have this talent so they will disappear.

The social democracy scenario would lead to insurance companies having too many expensive social benefits for their career agents. They might decide to allow agents to become independent deliberately. Rather than losing their agents, they might encourage independence in order to avoid paying fringe benefits. We have seen that in some of the Latin American countries. For example, in Columbia when the social benefits became too fierce, the companies turned all their career agents into brokers and developed new ways to keep in contact with them.

You might see a scenario with agent commissions being cut by law. The industry might lose its most talented people. The government interference would produce a self-fulfilling prophecy in which a weak industry would hasten the need for more government intervention and a smaller market. As a result, many companies would disappear.

The concern that we will not develop new agents in the future is ill founded. They may not be developed in the same way that they have been developed. We may not like the way they are being developed, but they will be developed when they are needed and where they are needed. New life agents are being developed and created among property and casualty agents every day. Under any of the three scenarios, we are going to see a survival of the distribution system.

MR. GROSS: Direct response marketing will be influenced by the size of the market and the marketshares. In the high inflation scenario, the need for insurance is going to grow. Everything will be inadequate including current levels of insurance. The problems that we are beginning to experience in the agency companies such as high expenses, policy loans, difficulty in recruiting, the shift in term insurance which leaves less money available for commissions, will be exascerbated. Under that system there will be a growing market and a growing difficulty in recruiting and paying agents to meet the needs of that market. And the direct response business would not be able to fit in. The direct response business penetrates those parts of the market in which agents cannot serve effectively. In the incentive and investment scenario, the agents would have less problems and be able to function better. This could mean less opportunity in direct response insurance. Over-regulation tends to favor the status quo, and deregulation tends to allow more innovation. So direct response marketing could become far more effective under deregulation.

What are the effects of evolution? Some of the large financial institutions might sell a lot by direct response. In the social democracy scenario, the government will take care of many needs, so the market will dwindle.

Another thing that might hurt direct response sales would be the breakdown the the U.S. postal service, or even 5-day mail delivery. Those who rely on the company to communicate with them by mail get a lot of mail on Monday already. They will get even more, and they will not be able to process it quickly or turn it around quickly. That might be a competitive disadvantage. Another area of concern is technological development. Technological developments tend to eliminate human beings and may affect the agent. Two-way cable television is being talked about. One can envision selling by television and quoting somebody a rate by television, and actually having the television set check blood pressure an have other medical devices and perhaps a physical without human involvement. That is a slight overstatement but it is unclear how much our society is going to change with technological innovation. As computers do more there will be the possibility to eliminate the interaction of the agent and sell more without him.

A final future development involves an increasing self-reliance. The medical area was always one where we have had to rely on experts. But there have been millions of self-pregnancy tests sold, and people are checking their own blood pressure. If people start to believe they can do without experts, they may learn to do without experts in buying insurance. Certainly buying an annual renewable term policy does not need much explanation. This trend toward self-reliance in other areas could lead to less need for the agent and more sales by direct response.

MR. DAVID RICCI: Do all the panelists agree with the assumption of a 25% decline in home service or debit sales relative to other distribution systems by the mid 1980's? One of the few systems that uniquely addressed the lower to middle income groups is the home service sales. What other systems will step in to fill the gap? Do we envision the private sector abandoning this group in favor of government intervention? Is it possible for debit business to undergo an evolution from tradition life sales to something involving a personal financial consultant?

MR. HILL: If someone were to project the trends over the last few years, he would have gotten a result showing a decline in debit sales. It is possible that debit sales may grow as fast as ordinary sales, but probably not. There will probably be some decline in the debit share of the market.

MR. JAMES: What is a debit system, or a territorial system? Labels are confusing. If a "debit system" consists of agents selling one policy in the ghetto, then the system will decline. But considering the multiple line sales, the sales of fire and casualty insurance by debit agents are rapidly increasing. No one system has an inherent disadvantage or an inherent advantage over another except when viewed for a specific purpose. There is no reason why a company could not evolve in the way suggested.

MR. BOURDEAU: I am kidding of course, but the numbers were 17.6 and we rounded that up to 20%. In 1985 it is going to be 17.4 so we rounded that down to 15%. It is an average based on today's definition.

MR. WILLIAM HEZZELWOOD: With respect to Mr. Gross's enumeration of the advantages and disadvantages of the mail-order distribution system, the major disadvantage not identified is the great potential for overinsurance in the areas of hospital indemnity coverage, disability income coverage and senior citizen medical coverage.