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DIVERSIFICATION OF LIFE INSURANCE COMPANIES

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1. What has been the recent experience in the acquisitions, diversification and corporate structure of life insurance companies?

2. What factors cause companies to change the forms of their operations?

3. How do life insurance companies go about deciding on the paths they wish to take and ultimately follow?

4. How is such change affecting the production (insurance and otherwise), marketing, profitability, administration, and management of our industry and our profession?

5. How might these developments further evolve in the 1980's and beyond?

MR. STEVE P. COOPERSTEIN: Good morning and welcome to this Panel Discussion entitled "Diversification of Life Insurance Companies." The panelists bring with them a diversity of vantage points within the insurance industry which should provide an interesting perspective to today's discussion.

Our leadoff speaker will be Fred Townsend. Fred, as a general partner of the New York Stock Exchange member firm of Conning and Company, prepares a research advisory service for institutional investors, provides an insurance industry analytical service to managements of insurance companies, and is co-author of a monthly newsletter entitled "Acquisition Analysis of Life Insurance Companies." He is thus well-qualified to provide an overview of the diversification and acquisition activity evolving in the life insurance industry today.

Our second speaker will be Ted Rosky, who is Executive Vice-President with the Capitol Holding Corporation, with responsibilities in the group insurance, property and casualty, product development, and human resources areas. Ted will describe how his company planned and is implementing a program of diversification.

Our third speaker will be Paul Overberg, Senior Vice-President and Chief Actuary of Allstate Life, which, as I'm sure you are aware, is a subsidiary of the well-diversified Sears organization.

Lastly, as your moderator, I bring to this morning's session a diversified background of fairly recent origin. For the last three years, I have been in Long-Range Strategic Planning at the Metropolitan. However, I decided to leave the Metropolitan after about 20 years and as of about a week ago, I embarked on a program of personal diversification to be an actuarial consultant to individuals on their personal insurance and related financial needs.

Before we begin, to set the tone for today's discussion, I'd like to bring you back to 1973 by means of the results of a survey I just came across. Diversification at that time was quite different than today. For example, diversification into product lines and businesses such as variable life, computer services, mutual funds, banking, property and casualty, and health maintenance organization were for the main just being looked into. Securities brokerage services offered through a life insurance company was almost unheard of! Now look at how things have changed.

With this observation as a prelude, I present our first speaker, Fred Townsend, who will discuss where the life insurance industry has come from and where it might be going.

MR. FREDERICK S. TOWNSEND, JR.: MAYDAY is the international distress signal used by sinking ships and disabled aircraft. Is the life insurance industry a sinking ship, and the career agency system limping along on a wing and a prayer?

In my own business, the stock brokerage industry, we use the term MAYDAY to designate that infamous day in May, 1975, when the S.E.C. eliminated fixed minimum commission rates on the New York Stock Exchange. Ultimately, commission rates to institutions and to individuals were reduced as much as 70% to 80%. Inefficient stock brokerage houses merged, sold out to other companies, or went bankrupt. Efficient stock brokerage houses revived and became substantially larger. Likewise, profitability increased for those companies able to meet the challenges of the hostile environment.

When your commission income is sharply reduced, what are the cures? In the stockbrokerage industry, several alternatives were available. Brokerage firms set out to broaden their revenue streams through the introduction of more products to raise the productivity, and the aggregate compensation, of their sales forces. Other firms eliminated high-cost services and offered products with low commissions, to be cost-efficient to consumers. Brokerage firms attempted to compensate for reduced commission rates by sharply increasing volume of business. Finally, many brokerage firms moved compensation for services to a cash fee basis rather than relying upon commissions alone.

So, here we are in May, 1982. I submit that this is MAYDAY for the life insurance industry. Why is the life insurance industry in distress?

High inflation rates and high interest rates have inhibited cash value sales, induced a shift from cash value to term, and caused the lapsation of mature in force policies.

High interest rates have led to a reduction in premium rates have caused stock companies to introduce lower-priced Indeterminate Premium Whole Life type policies to compete with for products, and have led to the introduction of Universal Life policies to compete with competitive yields on money market funds and certificates of deposit.

Improved mortality experience in recent years has led to a price war on term insurance rates, and the fracturing of term insurance premium rate structures by introducing re-entry term and non-smoker policies.

Thus, 1981 and 1982 have marked a product revolution in the life insurance industry. We are now in the unique position in the history of life insurance where the cost of insurance products is actually decreasing even with increased attained age! Indeterminate Premium Whole Life and Annual Renewable Term premiums are lower in 1982 than premium rates charged on Whole Life and Annual Renewable Term policies at a younger attained age in the 1970's. Under such unique circumstances, it has become cost-efficient for the consumer to replace policies purchased in earlier years.

Just as MAYDAY, 1975 sharply reduced the commission revenues of the stock brokerage industry, I submit that the current insurance product revolution has sharply reduced the commission revenues of the career agency systems. Dollar commissions per unit of insurance sold, are declining. This is attributed to the shift in sales from cash value plans to term plans, a reduction in term insurance rates of 50% to 75%, a reduction in Whole Life rates of 25% to 40%, and lower initial commission structures such as on Universal Life.

Where does the industry go from here? How can the industry compensate for increased replacement activity and declining commissions per unit of insurance sold? In my opinion, we are in the last throes of product revolution, and the recent acquisition and diversification activity of many life insurance companies signals the beginning of a marketing revolution.

The marketing revolution will be a battle of the field forces, not only from within the industry, but also from outside it. The career agency companies will have to fight for survival.

On a more optimistic note, the large established companies in the industry will find that their sizes will be an advantage, not the traditional disadvantage, in the life insurance industry. A select group of major companies have recruited, financed, and trained new agents for the entire life insurance industry, with smaller companies hiring away experienced agents from the major career-building companies. I believe this process will reverse itself in the years ahead, as smaller companies will not be able to compete in the diversified financial services area, and size will become more of a dominant market factor.

On the pessimistic side, the marketing revolution does not merely pit life insurance company marketing forces against one another. The marketing revolution also pits the life insurance industry against other distributors of diversified financial services. While life insurance companies may be sparring, jabbing, and feinting against other life insurance companies, the stockbrokers, banks, retailers, and cash management organizations will be sneaking up from behind and picking the pockets of the life insurance industry.

In my view, a life insurance company will have three ways to go to increase productivity in the life insurance marketing revolution. Some companies may pursue one of the three choices, while other companies may pursue two or three of the choices simultaneously.

The first alternative is to broaden a company's revenue stream. This approach will be followed by the major companies with career agency

forces. In order to compensate for reduced commissions per unit of insurance sold, companies must expand the number of products sold by career agents. The former compensation-driven (high commission) products will be replaced with consumer-driven (low commission) products. Product lines will expand into diversified financial services.

Secondly, the career agency companies which cannot compete with larger companies in the diversified financial services area will become manufacturers of products, and contract with independent distributors to sell their products. By trimming all aspects of expenses associated with career agency forces, such companies will operate on low, low expense ratios. Prices of their products will be the most competitive among life insurance compnies, and commission rates will be competitive as well.

The third alternative will be to seek incremental (or exclusive) sales through non-traditional sales outlets. The present flurry of activity in acquiring stockbrokerage firms represents the major marketing thrust at present. Companies have also been involved in association marketing, payroll deduction marketing, and direct mass-marketing for years, although this represents modest production results for most companies. Further competition may be expected from banks and other financial intermediaries as regulatory restraints are eased.

The combined thrust of the marketing revolution is to lower the distribution costs of life insurance products. On the optimistic side, I believe that the life insurance industry will emerge with increased consumer acceptance of life insurance products. While there will be a shrinkage of career agents within the industry, the agents of those companies which can survive the marketing revolution will benefit from substantially higher productivity and higher aggregate compensation.

The present diversification activity within the life insurance industry is designed to increase an agents' productivity and compensation levels through the following methods:

- A broadining of the revenue stream
- Use of low-cost distribution methods
- Use of non-traditional sales outlets

Examples of companies which provide sales representatives with increased compensation by broadening their revenue streams with diversified financial services include:

1. Sears (Allstate)

   Insurance operations were originally formed to write personal lines automobile and homeowners insurance, but the company now ranks as the tenth largest stock life company by face amount of individual life insurance in force. Sears has acquired a stockbrokerage firm for marketing investment products, and has diversified real estate interests through the acquisition of a mortgage banker, a savings and loan organization, and a mortgage insurer.

2. Kemper Corporation

   Kemper started as a mutual property-casualty organization, but

ranked as the second largest stock life insurance company by face amount of individual life insurance sold in 1980 and 1981. While the company gained a reputation as a low-cost distributor of term insurance products, and sold modest volumes of cash value insurance, a companion life company gathered cash savings by selling $0.8 billion of annuity premiums through stockbrokers in 1981. Another companion asset management organization had $14 billion of money market funds and municipal bonds series under management at year-end 1981. The company has recently acquired three stock brokerage firms to enhance (or insure) its marketing thrust in the investment community.

3. E. F. Hutton

By offering a broad product line of diversified financial services, this sales organization provides average compensation to its sales force exceeding $120,000 per registered representative. In 1980, this organization led all stockbrokers in the sale of tax-shelters ($0.5 billion), and sold $0.4 billion of annuity premiums. In 1981, this company wrote $44 million of first year ordinary life premiums.

4. Merrill Lynch

This sales organization epitomizes a broad product line designed to increase the revenue stream of its sales force. Average compensation exceeded $100,000 per registered representative in 1981. Sales representative are provided with a product line of 185 different funds, only 15 of which are managed by Merrill Lynch. They are willing to market the products of other organizations if it enables their own captive sales force to increase compensation. This organization is able to compete with money market funds, IRA accounts, single premium deferred annuities, universal life and variable life products, ordinary life and annuity products, municipal bonds, tax shelters, mortgage insurance, and cash management account.

5. American Express

This organization is combining communications technology with credit payment mechanisms to establish a firm foothold in diversified financial services. It will ultimately combine checking account, savings account, money market fund and stockbrokerage services for individuals. In addition to its most popularly known service of providing travelers cheques American Express owns both a domestic and an international bank, and has recently acquired three major stockbrokerage firms. Another subsidiary is the largest non-bank processor of credit card payments, and is a developer of automated teller machines. The acquisition of Warner Cable placed the company in cable television and an experimental program in two-way communications between the television station and the home viewer.

Thus, the marketing revolution in expansion of product lines and diversified financial services provided by companies with career agency forces will create a battle of the marketing forces between the life insurance industry and other cash management organizations.

Some other major life insurance companies have tried to diversify marketing activity through the acquisition of either low-cost distribution organizations or through the acquisition of non-traditional sales outlets.

Examples of companies entering or expanding their life insurance businesses through the acquisition of organizations with low-cost distribution systems include:

Lincoln National:	Security Connecticut Life
Ethyl Corporation:	First Colony Life
Tenneco:	Philadelphia Life
USLIFE:	Old Line Life
ERC Corporation:	National Fidelity
Monarch Life:	Fidelity Bankers
Washington National:	Anchor National
American General:	Variable Annuity Life
Protective Corporation:	Empire General
Liberty National:	United Investors

Examples of life insurance companies acquiring non-traditional sales outlets to expand their marketing operations include:

<u>Stockbrokers</u>:

Prudential:	Bache; Elkins; Bruns-Nordeman
American Express:	Shearson; Forster-Marchall; Robinson-Humphrey
Kemper Corporation:	Bateman-Eichler; Loewi
Sun, Canada:	Mass Financial Services
John Hancock:	Tucker-Anthony
Liberty National:	United Investors (W & R)

<u>Direct Marketing</u>:

Capital Holding:	National Liberty Corporation
Liberty National:	Globe Life & Accident
Combined Insurance:	Union Fidelity
United Services:	Bankers Security

MR. THEODORE S. ROSKY: My company, Capital Holding Corporation, recently acquired the National Liberty Corporation, which is a major factor in the direct response marketing of insurance products. This step could be said to be a diversification of a different kind -- a diversification of marketing system. It's my purpose today to discuss some of our thinking that resulted in this step, and then to explore briefly diversification of products.

The acquisition of National Liberty Corporation does not represent a flight from the agency marketing system. Rather, it is our hope that it will be a way to augment the resources available to our agency operations. To see how we arrived at this point, it's useful to turn the clock back a few years.

In late 1979 and early 1980, we constructed our first strategic plan. We began by assessing the prospects for the life insurance industry for the

decade of the 1980's. We looked at the expected environment, at our organization's strengths and weaknesses, and at our opportunities for growth during the decade. We expected an average annual rate of inflation of 9 percent. We determined that we wanted to produce earnings growth sufficient to support dividend growth and to increase our shareholder equity fast enough to outpace inflation so as to leave our owners ahead of the game after adjusting for inflation and capital gains taxes. We calculated the earnings growth rate that was required to produce this result.

We next took a look at our existing business base, and determined the earnings growth rate we could expect -- assuming that we continued those programs which currently were underway and that we embarked on no new programs. This expected growth rate was significantly less than what we had determined that we wanted to produce. We had what we called an "earnings growth gap."

Part of this gap could be filled by upgrading our existing business base, and a number of specific areas of opportunity were identified and quantified. We felt the balance could come from a leveraged acquisition of a faster growing insurance or non-insurance company. We were especially interested in organizations which could bring to us diversification of marketing process and the potential for synergy with our existing organization.

All of this work resulted in the creation of a business plan which was approved by our Board in February, 1980. We then began to evaluate business segments for potential acquisition activity. One of these segments was direct-response marketing of insurance, and one of the major factors in this area -- National Liberty Corporation -- was for sale. We began discussions with National Liberty in the spring.

Several factors made National Liberty an attractive addition to the Capital organization:

- Earnings growth potential was very good, and National Liberty met our objectives for a leveraged acquisition to increase Capital's earnings growth;

- Direct response marketing was producing impressive results in insurance and other areas, and we wanted to be a factor in this emerging field; and

- We saw some attractive marketing synergies -- National Liberty had proven lead generating capacities, and we saw great potential for using these to increase the productivity of our agents. On the other hand, more complex products are hard to sell through direct response methods -- an agent is required -- and the Capital organization had a sizable number of agents.

The acquisition agreement was announced in June and the balance of 1980 was occupied with all the steps needed to consummate the transaction. The closing took place in January of 1981. We deliberately chose to wait before exploring for marketing synergies. During 1981, we had three principal priorities:

- Getting to know the National Liberty organization:

- Wiring them into the Capital system in a way which preserved the entrepreneurial spirit which had served their organization so well in the past; and

- Continuing the several major initiatives underway in our agency companies.

For 1982, we are turning our attention toward experimenting with ways to use direct response marketing methods in conjunction with an agency force. Our objectives are to increase both total sales and agent productivity. Marketing experiments were begun in March, with television used in eight markets, and targeted mailings in 15 markets. Three insurance products are being featured. Leads are being followed up in three different ways:

- Some are turned over immediately to an agent for follow-up.

- Others are followed up with a kit being mailed in response to an inquiry, and when a completed application is received, the policy is given to an agent for delivery and collection of the initial premium.

- Others are followed up using a standard direct response methods, all the way through to the mailing of the policy -- with assignment to an agent for servicing afterwards.

We believe that the presence of an agent will increase the number of inquiries which are converted to closed sales. The unanswered question is whether the close ratios can be improved enough so as to make this a viable approach. We'll be measuring results for each product and each follow-up method. Those which prove attractive will be expanded.

Now for some thoughts on product diversification. Clearly, our industry is at a crossroads. Insurance companies, banks, securities dealers, investment companies and other financial services organizations in the past were able to co-exist peacefully. This no longer is the case, as we all can tell from reading the daily newspaper. Driven by the impacts of inflation, high interest rates and increasing cost levels, everyone is invading everyone else's turf.

Money market funds, certificates of deposit and other competing investment vehicles have pulled savings dollars away from the permanent life insurance product line. For the industry, ordinary life premiums as a percent of disposable personal income decreased from 3.3 percent in 1940 to less than 1.7 percent in 1980. And ever increasing cash value borrowing is further eroding the assets we manage. Term insurance is becoming increasingly popular as inflation simultaneously increases the amount of needed insurance and decreases spendable income. In 1956, term insurance accounted for 33 percent of the industry's new individual life insurance sales; by 1980, term coverages had increased to almost 55 percent.

Individual life premium growth has been affected negatively by the growing popularity of competing investment vehicles and term insurance,

and by the continuing decline in the cost of insurance resulting from improvements in mortality and investment yields. Agent incomes are based on premium receipts and have not kept up with the inflation; and at the same time, the agent's cost of doing business is increasing.

In closing, I want to come back to the notion that agents need to increase the number of sales that they make. One way to do this is to find more prospects. Another way to do this is to sell a greater array of products to those prospects which are found. This is more easily said than done, however. There is a limit to the number of products and product lines that any individual agent can handle. This is increasingly true as products become more and more complex. I wonder whether the fast advancing computer technology won't provide a good solution here -- leading the agent through product selection and design via some sort of computer assisted process.

These are exciting times. Both our industry and our profession are on the verge of significant change and transformation. Charles Dickens said it well: "It is the best of times; it is the worst of times." We have before us an enormous opportunity for those who are willing and able to change.

MR. PAUL J. OVERBERG: I am going to be reviewing the general state of the industry today, Sears in particular, and, the future outlook as I see it. I will also make some comments on product mix.

Diversification is nothing new. The year 1957, for example, was a memorable year. That was 25 year ago. IDS started a life insurance company and opened the life insurance market to their mutual fund salesmen. Also that same year, four property and liability companies started life insurance companies with the life products to be sold by their casualty agents. Those companies were:

INA,
Sentry,
Safeco, and
Allstate

For decades, the life insurance industry has had its share of mergers and acquisitions -- some of which were attempts at diversification. The lists of such activity have been duly noted in the various industry publications.

The most interesting point, though, is that these same publishers have treated the life insurance industry different than they have treated the property and liability insurance industry. Each year, they publish the casualty statistics (such as premiums written) by company groups. But, I have never seen them publish life insurance company data by groups of companies showing a common ownership. In reviewing 1981 statistics, this was an important point in as much as several major companies placed their new business in a different company in 1981 than they used in 1980. Without statistics by company groups, it is difficult to measure the effects of the many mergers and acquisitions.

An NAIC working committee did make a study covering 1978 life insurance premium income by company groups. The results show a high degree of concentration of business into relatively few companies.

At the end of 1978, there were some 1,840 legal reserve life insurance companies. But if these companies are grouped by common ownership, there were only some 996 different groups of companies.

The premium income during 1978 of these groups was highly concentrated.

- The largest groups had 60% of the total industry premium income;
- The 54 largest groups had 75% of the market; and
- The 152 largest groups had 90% of the market.

Incidentally, at the Orlando meeting, Rod Rohda, in the panel discussion covering this same subject, reported that every one of the 25 largest mutual life insurance companies had at least one stock subsidiary. Fourteen of these were acquired or formed within the past two years.

A lot has been happening in the life insurance industry. In addition to there being a concentration of business within our industry, there is also an increasing number of life companies expanding out of the traditional life insurance products. At the same time, other types of financial institutions are getting into the life insurance business.

Table A shows six financial giants in the U.S.

TABLE A
SIX FINANCIAL GIANTS
1980 FINANCIAL DATA

	BILLIONS OF DOLLARS			SELLS
			NET	LIFE
	ASSETS	REVENUES	INCOME	INS.?
	$	$	$	
AMEX	24	7	.5	YES
CIGNA	27	11	.6	YES
CITICORP	122	17	.4	NO
MERRILL LYNCH	16	4	.2	YES
PRUDENTIAL	68	13	--	YES
SEARS	33	28	.6	YES

The purpose of showing these six giants is to remind you of our competition. They are big. The figures on this chart are all in billions of dollars. The net income after FIT of these giants is greater

than the gross premium income of the vast majority of the life insurance companies. And note that all but one of these giants sells life insurance.

Now let's look at a little more detail of the last giant listed on this chart, the one I am associated with, the Sears organization.

The Sears organization currently has four major divisions:

- The Sears Merchandising Group (World's largest retailer);
- The Coldwell Banker Real Estate Group (U.S.'s largest independent real estate broker);
- The Dean Witter Financial Services Group (U.S.'s fifth largest securities brokerage); and
- The Allstate Insurance Group

Each group has its own strategic plans and each group is measured on its return on equity and its ability to increase its revenues.

In building this organization, Sears placed a great deal of emphasis on concepts and not on details. The detailed synergistic opportunities were not spelled out prior to the latest two acquisitions.

It was felt that given the right atmosphere, the synergistic opportunities would emerge naturally. Since two of the groups were just added within the last six months, we have yet to begin to capitalize on the potential interplay of these four groups.

In about two months, Sears will start testing financial centers in 8 different Sears stores. These financial centers will house:

- Allstate insurance;
- Dean Witter; and
- Coldwell Banker.

Frankly, we don't know how successful these financial centers will be. But we are going to find out and we are going to find out how best to serve the customer family and how to capitalize on any synergistic opportunities.

Sears has good reason to believe that these financial centers will be successful. The Allstate booth has been a key to Allstate's Success. Furthermore, Sears has studied their customer family. Here are some of the results.

- Sears has approximately 40 million credit card customers.

- About 25 million of these are active, that is, they have been used in the past six months.

- 57% of all households in the U.S. have a Sears card; 11% have an American Express card.

- 70% of households with an annual income over $36,000 have a Sears card.

- 76% of all persons with a net worth of over $500,000 have a Sears card.

- 62% of brokerage house customers have a Sears card.

- 73% of stockmarket customers investing over $25,000 per year have a Sears card.

Last December, Sears started their money market fund. But before they started it, a study had indicated that over 600,000 regular Sears retail customers would be interested in an investment account with Sears.

This is just the Sears merchandising family. Each of the other three divisions of the Sears organization also has its own family. Admittedly, there is much overlap. Allstate alone has some 21 million policies inforce with almost 11 million different customers.

The financial giants are indeed awesome, and the action of the giants gives every indication that they are not content with their present market share. If they are to increase their market share, where is it to come from?

For generations, we in the Personal Life insurance industry prided ourselves with being an industry that did not have to rely on obsolescence and replacements for new sales. But is this still true today?

In auto insurance, agents are trained to get the "x" date of every one they see. Their basic source of sales is replacing business that is currently in some other insuance company. In group insurance, we have been doing the same.

In recent years, we see some life insurance companies and agents specializing in replacing existing personal life insurance rather than creating "new" sales.

An important question to ask yourselves is, "how will your company fare over the next ten years. Will a giant eat you up and/or will your inforce business be replaced by your competition?"

Another question relates to types of products the industry will be selling in the future. For the last decade, we have been listening to many speakers discuss their concern with the demise of whole life insurance. They base their fear on the rapidly increasing share of the market that is represented by term insurance sales. This is shown in Table B, measured by amount of insurance sold:

TABLE B
PERSONAL LIFE INSURANCE
TERM, WHOLE LIFE & OTHER CASH VALUE SALES

LIFE INSURANCE PURCHASES IN THE U.S.
INDUSTRY SALES

DISTRIBUTION OF SALES
BY AMOUNT OF INSURANCE

YEAR	WHOLE LIFE* %	TERM %	OTHER CV %
1970	26	20	54
1971	27	22	51
1972	26	23	51
1973	25	24	51
1974	24	29	47
1975	25	31	44
1976	25	33	42
1977	26	34	40
1978	27	38	35
1979	26	38	36
1980	23	43	34

* WHOLE LIFE IS DEFINED AS POLICIES WITH LEVEL INSURANCE AND LEVEL PREMIUMS TO AT LEAST AGE 85

Term sales have grown from 20% of all personal life ordinary sales in 1970 to 43% in 1980. (These figures are for pure term insurance and exclude term combined with basic cash value insurance. Thus, they differ from the data used by Ted Rosky. But both Ted's figures and mine illustrate the dramatic increase in "term" sales as a percent of total ordinary sales.)

But little attention is given to the composition of the rest of the sales. If we separate whole life sales from other cash value sales, we see that whole life sales have held their own at about 25% over the last decade, though there appears to be some slippage in 1980. 1981 data is not yet available, but should be very interesting. Whole life insurance is after all just another way to pay for term insurance. And to many customers its the only way they can afford to keep their life insurance in force at the higher ages.

Our industry has lost its share of the consumers' disposable personal income that is spent for life insurance. It has dropped from 3.1% in 1970 to 2.3% in 1980. Incidentally, my figures include group and industrial insurance. Ted Rosky indicated we had only 1.7% of disposable personal income in 1980. His figure was for "ordinary" life premium only.

This brings out the well known fact that our industry has for many years been diversifying into group insurance.

We also sell annuities. And when we add in annuities, both group and personal, our share of disposable personal income was 3.6% both in 1970 and in 1980.

Thus, we as an industry, are not losing market share, but are just changing the types of products we are selling and the distribution system.

Some may question whether these changes are to the consumers best interest -- considering the taxability of annuity proceeds to the beneficiary. To me, it suggests that even with Universal Life -- there is still much opportunity for product innovation.

A few minutes ago, I spoke of the financial giants and even suggested that they might gobble up many smaller companies. But that need not be the case.

Two weeks ago, the nation celebrated National Small Business Week. I don't know how many of you joined the celebration. But I enjoyed the CBS weekend radio comments. During the entire weekend, they played tribute to the accomplishments of small businesses.

Unfortunately, I do not have a hard copy of the many statistics they quoted. But for each industry that I heard them discuss, the same story came through. Virtually every major development in the last 10 years has come from small businesses. And indeed it was rare when a giant corporation was responsible for any significant innovative change.

I did not hear them mention the life insurance industry. Yet I am sure some small life companies will take advantage of the situation and be the innovators of future life insurance products.

MR. STEVE P. COOPERSTEIN: I would like to touch on this subject matter based on my unique (everyone is unique in their own way) recent work experiences -

- First as Vice-President for Long-Range Strategic Planning at the Metropolitan, where I looked at the whole subject of distribution systems;

- Second, in looking into various marketing opportunities after I decided to leave the Metropolitan;

- And third, in terms of diverisfication of Actuaries.

Marketing and its Basic Components

As an overview, I would like to state that the key common denominator that I have found - and I believe the key to today's subject of diversification (and also to the success of this panel, this speech, etc., etc.) - is MARKETING. Interestingly, Funk and Wagnalls does not define marketing, per se, though its definitions of market, marketable, marketplace, and market value use such words as selling, buying, buyers, etc. On the other hand, many books have been written on marketing; I found the definitions described by Derrick Abell in his book, "DEFINING THE BUSINESS: The Starting Point of Strategic Planning", to be most meaningful to me. Paraphrased Mr. Abell defines marketing as a system by

which customers' needs are satisfied by selling products to them through an appropriate distribution system. Let me reemphasize the four interdependent and fundamental components of this definition - customers, their needs, the products sold to them, and the distribution system for getting it out to them. This definition seems to be in common usage, both objectively by people who study the marketing concept and subjectively by those who are successfully practicing it, even though the latter group may not explicitly spell it out. For instance, Paul Bourdeau, Senior Vice-President of Phoenix Mutual, in teaching the Society's recent Seminar on Market Research, identified these same four components in defining marketing. Paul, though added a fifth component - merchandising. (While I fully agree that this fifth function is an important element in marketing, I choose to combine it with the product and/or distribution components.) As to subjective examples, they are innumerable. The classic in our industry, I think though, is the marketing of Industrial Life insurance through the debit system to working class people as part of the industrialization of America. Direct response may be the next "natural" marketing success.

What does all this marketing jargon have to do with the diversification of life insurance companies? You've heard Fred's description of the movement in the industry and Paul's and Ted's remarks about how their companies have gone through the process of diversification. I think its pretty clear from their remarks that a lot of what has been happening - but perhaps not enough - has been connected to the marketplace. I'd like to briefly add my examples.

Diversificatin at the Metropolitan Based on its Market

First, my experience at the Met. The Met, too, went through the process described by Paul and Ted. Briefly, looking at the Met's Personal Insurance markets, we found that our clientele were primarily from the lower-middle income sector. These clientele - and I am not saying which came first, our clientele or our marketing to them - were found in turn to affect our products, merchandising, distribution system, etc. - the price of our products, the services we supply, and the sophistication of our sales force. We found that while we were well positioned in this customer marketplace (most life insurance companies were fleeing from it though not necessarily Capitol Holding or Sears) our clientele did not really have a strong need for more personal Life Insurance as a result of the growth of Social Security and Group Insurance. Thus, our concentration on this market had hurt our sales (but not necessarily our margins) more than it has hurt the sales results of other companies.

Armed with our definition of marketing, (and I might add that they turned out to be consistent with the paths espoused by Philip Dutter in his now famous paper "The Coming Life Insurance Shake-up: Who Will survive"), the choices for change became obvious:

- change our clientele;
- change the needs we address; or
- recognize our shrinking market, changing our distribution systems and/or our products in response.

We had done some of each of these. For example, among other things we diversified into property and casualty; we targeted on salary savings and brought the salesmen out to the people in booths in shopping centers; experimented with direct mail; reduced the size of our field force, while trying to improve its quality; and changed many products. And I think you'll see more changes as Met refines its plan after further study of the marketplace.

Diversification through the Field and Their Contact with the Marketplace

The second set of observations I would like to share came about after my decision to leave the Metropolitan. My experience, talents, and interests suggested that I would like to be in charge of my own marketing operation. This led to my talking to many people in the industry. As I did, patterns started to emerge as to the way in which life insurance companies were diversifying, at what stage in the diversificatin process they were in, and why.

Basically, I found that the state of diversification on the individual side of the house was closely aligned with the managerial system employed by the company, i.e., branch, quasi-General Agent, or pure General Agent. And this I found in turn was related to marketing in terms of which of these systems was best at marketing, how, and why.

And then you come back to the fundamental principle, and that is clearly, sales offices, both salespeople and field management, are closest to the marketplace. In the home office we executives relate to the marketplace mostly in terms of our personal feelings and experiences, and those of our friends and other acquaintances - but we're really cut off from the true marketplace by our field distribution system. (As an aside, I might mention that one of the nice things about direct marketing is that this cut-off doesn't happen because direct response enables home office executives to gain a direct appreciation of the marketplace, albeit more on a statistical than personal basis. Group executives have an even better market exposure.) But given that salespeople and their managements are closest to the personal marketplace, and given the fact that, as Fred has descirbed it, many of our marketplaces have been changing and our profit margins decreasing, it is not surprising that the pure General Agent, the entrepreneurs, the ones who are truly running their businesses in the market, are most apt and in fact are the ones who are responding the greatest to the marketplace. As a result, for survival as well as profit, it is these General Agents that have begun to diversify, on their own, and before their companies. In many cases, these agencies have then been supported or followed by their companies.

An excellent example is in the case of brokering. Customers have become smarter, shopping for instance, so agents were forced to broker cases. In turn the better General Agents began establishing their own brokering arrangements with other companies to capture the business. The "pure" General Agency companies like Mutual Benefit and Penn Mutual took this route. More recently companies such as Lincoln National and Connecticut Mutual, which I would categorize as "quasi"-General Agent, began to establish affiliations at the company level to sell products of other companies or diversify into equities, tax shelters, and financial planning, attempting to keep in tandem with their General Agents. The large managerial mutuals have generally not moved or not moved successfully in these directions because of seemingly weaker market

contact and less entrepreneurial spirit. Of course, you might suggest that Northwestern Mutual is a major exception to this scenario: they have a very pure General Agency system, but have remained relatively pure vanilla. In their case, though, I think the difference can be found in their very market research oriented Home Office.

The key point and suggestion here is

a) to understand that your contact (or non-contact) with the marketplace is very much influenced by your field operation; and

b) if you want to inovate (and you should), get closer to your marketplace.

Diversification of Actuaries in Response to the Marketplace

Lastly, I'd like to touch on the diversification of actuaries in response to the ever changing marketplace. Since my market today is you and your needs in making this speech and since in addition to your current technical assignments and affiliations you are each a company unto yourselves, I have a feeling that this part of my discussion will be of greatest interest to you.

First, "What is an actuary?" - that is the age old question we have all been asked and pondered. You've just heard that the Public Relations Committee of the Society is still actively considering this exact question. When I am asked this question by lay people I simply say that "We're the brains behind insurance companies". I was recently taught a further nuance about us by a deep thinking General Agent who had spent several years in his Home Office. He subdivided actuaries into those that were technical brains and those that were generalist brains, each seemingly excelling and having many opportunities in this changing environment.

For instance, technical actuaries seem required in ever expanding areas such as evaluating acquisitions; coming up with the basis for returns on investments, looking more closely at margins and allocations; becoming involved in matching assets and liabilities; getting into investments and expenses, especially with respect to taxes; as well as continuing to study mortality and morbidity. They are also moving more and more into technological areas such as computers and genetics.

Generalists are involved in these same areas though they seem to get more involved in marketing, organization, strategic planning, heading up new operations, tax planning, management consulting, etc.

Traditional examples of some of these diversifications can be found in the numerous actuaries who have taken their expertise into consulting, primarily in pensions or advising small insurance companies. More and more, though, actuaries seem to be going in even more diverse areas. One of the classic examples is Gerry Golden's establishment of Variable Life for Monarch and Merrill Lynch; Dan Gross in Philadelphia is now involved in, among other things, setting up a sort of product development middleman arrangement between the marketing departments of insurance companies and distribution outlets; and Brian Daily, former Chief Actuary of Penn Mutual, is giving expert advise on large personal and business insurance cases.

I am another example of how one, just as a company, might find his niche. In this respect, I briefly recommend the guru book on job search "What Color Is My Parachute" by Richard Nelson Bolles. Please note that I am not saying that everyone should change jobs, per se, but I do think the book is helpful, and that everyone should try to establish his or her fortes, and move towards it.

As I said, I myself, found that I was interested in running my own marketing operation. Through the process of talking to a hell of a lot of people in my marketplace and responding to their needs and mine, I evolved into a niche which I believe is responsive to the marketplace for advice about insurance and related financial matters, i.e. the marketplace

a) is confused by our mumbo jumbo products and illustrations

b) doesn't trust commissioned salespeople

c) is asking for lower premiums which which cannot support commissioned salespeople; and

d) is willing to pay for professional advice.

In all diversifications there is a risk, reward function operative. My observations, contention, and hope, is that by responding to the marketplace, diversifications can be carried off successfully.

MR. KEN ROBERTS: In the chart on Table B what kinds of policies were included in the column headed "Other Cash Value "Products"? The figures would seem to indicate that there might have been a move away from what most people might think of as permanent insurance.

MR. OBERBERG: The chart contains figures that are taken from LIMRA surveys. As the first column only contains Whole Life Insurance with level premiums and level amount of insurance to at least age 85 and the second contains pure term insurance, yes, there has been a move away from permanent or savings-oriented permanent insurance (e.g., 20-pay life, retirement income, limited pay whole life, etc.).

MR. COOPERSTEIN: In listening to the other speakers today, the thought occurred to me as to whether diversification has proved to be successful, except perhaps in an inflationary economy. Diversification may be watering down a company's effectiveness in terms of manpower, net cost, and expense management. For instance, what would happen to over-diversified agent-oriented salesforce operations should consumers be able to shop for insurance products by use of a computer link-up to their television sets, especially if inflation were to abate?

MR. ROSKY: Yes I think diversification would still pay. The market forces are there and they will continue to be there because they're in motion.

MS. NEELA RANADA: Mr. Cooperstein, you categorized three types of companies - the general agency, quasi general agency, and the managerial type. What is the prognosis for success in the marketplace by type of company.

MR. COOPERSTEIN: The point I was trying to make was that those companies which pay attention to the marketing process and the marketplace itself are the ones that will survive. General agency companies will probably be in the best position to do so because general agents are by design (and nature) entrepreneurial types - pure businessmen - and are in a better position to respond to the marketplace. That is not to say that the general agency organization is necessarily better than the managerial type. But its entrepreneurial characteristics make it more responsive to the marketplace.

MR. ROSKY: I would like to add that I would think the agent-based companies, in order to be successful, will have to closely monitor and identify the products which their producers have the best success in selling. This will require that companies be prepared to diversify into other product lines or businesses. There are many companies which sell on strictly a brokerage basis, which if competitive, can cut into a general agency company's book. I think the Merrill Lynch approach of selling a lot of companies' products through one sales force makes a lot of sense - it provides them with a great deal of control over their marketing process.

MR. COOPERSTEIN: I think one thing we'll be seeing more of in the future is general agencies soliciting business on a fee basis. On my upcoming endeavor, I expect to be providing services on such a basis. A number of companies I talked too were, seriously considering this route, very interested in this and are close to doing so. The principal advantage is that one can establish a customer first and sell products second. General agents just cannot afford to sell low premium-low commission products without a fee.

MR. TOWNSEND: A trend we have seen in the general agency area is the formation of large independent marketing outlets. These are general agencies which have, by one means or another, split off from their parent companies because they were not responsive to their product needs. They now solicit business from the "product-manufacturer" companies, who in turn are very responsive to their product needs. There is tremendous pressure in the general agency companies to hold onto the business produced by their largest production sources.

MR. COOPERSTEIN: Another thing that general agency companies are doing is "contracting out" services instead of diversifying and making themselves expert in everything. One general agent, for example, had 10 different subsidiaries-businesses. For instance, he provides investment advisory services and owns a gas and oil-drilling company for profit as well as as a base from which he can establish limited partnership scenarios. Another also had investment advisory services.