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DISTRIBUTION SYSTEMS

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An examination of alternative and supplementary types of distribution systems. Discussion will address career agents, brokerage outlets, personal producing general agents, and direct response systems in light of current economic conditions.

MR. MARTIN L. ZEFFERT: I would like to begin by introducing the members of this panel. You all have probably heard of our two speakers in the last 20-25 years because they've been doing things instead of talking. First, we will hear from George Joseph, who is now retiring as President of Life Insurance Marketing and Research Association (LIMRA). Previously, he was with the New England Life Insurance Company. Next, we will hear from Frank Crohn, who retired recently as Deputy Chairman of the National Benefit Life Insurance Company in New York. Now, he is the CEO of Women's World Financial Corporation, the parent of the First Women's Life Insurance Company.

MR. GEORGE G. JOSEPH: I have been asked to discuss various distribution systems in light of current economic conditions. My observations about the distribution systems and the life insurance business will lead me to roam across a broad set of facts and some personal opinion. Later on, you can challenge me in the question and answer session. I will start out with the fact that this afternoon somewhere there are 250,000 people whom we can describe as the population of the agency force in this country. We believe that this 250,000 agency force is going down to about 220,000 agents in the next five years. We, at LIMRA, have just published a paper called "Distribution Systems in the United States." We point out that manpower in multiple line companies will increase by 2-5%, while career ordinary and combination companies will reduce their manpower by 2-5%. Prognostications about agency forces going down to 25,000 or 50,000 people is pure nonsense. If not another agent were hired in this business between now and 1990, there would still be at least 125,000 agents selling the security products of the insurance business over the next 8-10 years. Actually, last year recruiting went up 1%, and we believe the field force has become stabilized after 4 years of decreasing in size.

One reason for my optimism about the growth of the agency force is that a few years ago, our aptitude index was given to 7 persons and only one of them was hired. Last year, 17 people were tested before 1 person was hired. Managers, general agents, and the recuiting companies are being more selective now.

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**Mr. Joseph, not a member of the Society, has recently retired as president of LIMRA

There are two distribution systems for delivering our products. The first is through agencies and the second is through direct response marketing. The distribution strategies are the key. The most commonly employed are Personal Producing General Agents (PPGA), brokerage, multiple line, home service, or a combination. The reason there is need for strategies can be found in the following figures. For instance, if a company has an 8% retention of agents into the 4th year, it will cost that company $180,000 for development for each agent, and that agent will stay only two years. If there's 20% retention, the cost declines to $121,000 and the agent stays 4 years; 37% retention -- $75,000 cost and the agent will stay 15-17 years; and at 50% retention, the agent will stay over 25 years at essentially no cost to the company. Therefore, how many companies can afford an 8% or 20% retention? It's out of the question, so subsequently companies opt for an alternate distribution system -- they blame the agency system when, in essence, they should be blaming themselves. They have neither appointed capable field managers, nor instituted proper training to create an efficient organization.

Of 1,800 chartered companies, only 110 are actively recruiting new agents into the business. And 48 of those companies, in the worst and most turbulent times this business has ever had, had a significant gain in manpower. So, the field force will be around for those companies that are committed to it. Other companies will obviously make different kinds of decisions.

Another problem the companies are having is with the share of an agent's business that is given to one company. We have been conducting a survey of agency opinion for the National Association of Life Underwriters every two years since the early 1960's. In 1978, we asked the agents in this survey how many of them gave 100% of their business to one company. 52% of the agents said they gave all of their business to one company. We asked the same question in 1980 and 48% of the agents said they gave all of their business to one company. We asked the same question this summer. These figures haven't even been publicized yet. However, 27% of the agents said they gave all of their business to one company. In the product-driven and tax-driven industry of the last few years, the agent tries to find the right product for the prospect, or perhaps the best commission deal. If his company does not satisfy these requirements, the agent strays away from the company. This creates a very serious problem for career agent companies today. But, I believe this trend will turn the other way.

Now, companies are doing the obvious with these kind of statistics. They're closing agencies, strengthening their field management, curtailing home office expenses, and many companies are forcing general agents to become very independent general agents. These people manage their own business, and go to the bank to borrow money instead of going to the company. Some general agency companies will become much more independent from their general agents than they ever have in the past.

We're also seeing some companies beginning to combine district agents and ordinary agencies. I know of one very large company in this country that is planning to consolidate its ordinary agencies and district agencies over the next five years. There isn't that much difference between the agents anymore. They're all serving the same territory, and they're basically in the same markets.

I have also observed in the last couple of years companies cutting down on their territory. It's beginning to make a lot more sense for a company to get a 10% increase in the market share in one state than to go out and try to get a market share increase in 20 states and spend a lot of time and get nothing.

Many people feel direct response is going to take over. I believe it's here to stay, and will expand its marketplace. But for the above reasons, I don't believe direct response will take over the business, and Frank may address this further. Our 1981 statistics on growth in direct response are similar to those in the 1974 study with virtually no increase. I believe they will increase over the next 5 years, but I don't think they're going to run anybody out of business.

Last year was an important year for products. Helen Nonowicz wrote a paper indicating that companies selling Universal Life and other competitively priced interest sensitive life insurance products allowed ordinary life premium sales to maintain a positive growth as many consumers opted to purchase IRAs instead of life insurance. 90 million people were eligible for IRAs last year. This had a very important impact on our market but none of us really looked hard at it and realized that impact until near the end of the year. Helen said the sale of Universal Life policies by an increasing number of the major companies will be important in 1983. The increasing market share of the modified term product and the rapid introduction of low-priced interest sensitive cash value products based on current rates, current mortality, and lower expense assumptions, in her opinion, will create about a 14% increase in annualized premium income this year, and about a 30% increase in sales. Some of those sales will naturally be replacement. However, people are not replacing with other products, but with life insurance. Our security products are still being bought by the people who owned them before -- almost 160 million Americans.

An interesting statistic on death claims is that the average age of claim is 73 years old. People buying term insurance, that is priced based on lapse expectancy instead of life expectancy, are going to spend a lot of money for life insurance if they live to 73 and continue paying the increasing term premiums. Therefore, the future for permanent life insurance is good due to the permanent need for protection, and I consider permanent life insurance to be such products as Universal Life and Variable Life, as well as Ordinary Life.

Now, I do not agree with the opinion that small companies will fail because they can't keep up with the technology, computers, and the products. The companies that will fail in the future are going to be the companies that are poorly managed. And there are some very big companies that are being poorly managed today as well as small companies. The companies that are well managed, that pick a place in the marketplace, that are tough in their expenses, that have the correct distribution system for the products, and get their training organized, are the companies that will still be around in five and ten years.

There's a place for financial planning, but it's not a place for every company. Nobody has ever defined or will be able to define for a long time, financial planning. There are people who call themselves financial planners who are nothing but simple programmers. They don't understand some of the regulatory problems they're going to be running into as they market these products. The security salesmen are not going to force us out of business. The banks are going to be very tough competition in 5 or 6 years if they do get the privilege which they're working on, i.e. selling life insurance. But, the banks cannot destroy the agency system.

MR. ZEFFERT: Frank Crohn is our next speaker.

MR. FRANK T. CROHN: The title of my talk is "Life Insurance Marketing -- A Continuous Search for Alternatives." After a brief history first, I will talk about mass marketing, and then the Women's project.

Life insurance began in this country before the country itself began. The Presbyterian Ministers' Fund, with antecedents back to 1717, began operations as a life insurance company in 1759. Here, in Philadelphia, it was a mutual company then as it is now. Other life companies came and went during the balance of that century. But the great seed stock companies of our nation took root in the middle decades of the 19th century. It was during this period that many of today's leading companies began operations and issued their first insurance contracts.

Initially the buyer had to come to the seller. As you can imagine, this resulted in a low volume of sales. Then, an alternative marketing concept came along that changed the face of the industry forever. Arrangements were developed which authorized an individual to represent the company and to receive an extra commission on the salesmen that he would hire. And so the general agency agreement came into being. This change coincided with others, such as the inclusion of net reserve valuations, non-forfeiture values, and the contestible clause.

The general agency system was largely entrepreneurial as the possessors of the master contracts from the company had to put their own funds into office initiation, staffing, and sales development. The branch office system came into being as an alternative method, where the companies employed their own capital in the ownership of sales centers. When the general agent separated from the company, the carrier's name was removed from the door and another substituted. The general agent's life went on. However, when a manager left, personal possessions were removed, a new manager arrived to take over, and all else remained the same. Thus, with this change, the companies took a firmer control of the destinies of their overall sales development. The loyalty shifted, and the producer became reliant on the company for payment, motivation, direction, and product.

The latter part of the 19th century was filled with momentous opportunities for the life companies. Using the panic of 1873 and the depression of the 1930's as bookends, the six decades in between saw great geographic and population growth in the country as new communities were established everywhere. This same period heralded another alternative marketing method -- the development of the debit system. The Prudential Friendly Society, soon to become better known as the Prudential Insurance Company, in 1875 initiated the debit or industrial system, where small policies were issued without examination. As part of this system, the specialized agent sold the policy and was then responsible for collecting the premiums and building and maintaining the level of that book for debit. The smaller issue amounts made every family member a prospect. Shortly after this, John Hancock joined the same marketing method. Four years later, Metropolitan Life turned its attention to the same marketing concept.

The successful force of this new technique of simplified policy sale in carving out tiny, exclusive, and protected agent territories, led this trio of companies to the nation's top leadership in premiums, assets, sales, and insurance-in-force. Although initially concentrating on the industrialized areas, eventually there were few homes in the country without the familiar collection envelope. This was an alternative marketing method that was very successful. In 5 years, the debit in force grew a thousand fold, in 15 years, 5,000-fold. Some companies followed, but others -- known as the ordinary companies -- decided to stay out of the business and concentrate on their own agency-building techniques.

The great depression of the 1930's saw the failure of many types of financial institutions, but the fine record of the insurance companies in weathering the worst of the bad times gave renewed confidence to the public in the use of the life insurance policy as a savings vehicle. The late 1930's and the following decade of the 1940's saw the impact of the U.S. population on the development of Social Security. National service life insurance in the 1940's gave a $10,000 policy to each of its service personnel. These forces, combined with rising income patterns and the dramatic increase in number of people covered by certificates under group life plans, changed the perception of how much life insurance a person or family should own. And the debit concept began to fail.

This was further accentuated by a growing buyer concern with insurance costs, values, and product. While this was happening, other changes were taking place in the agency structure in the industry. Mutual companies were still the dominant force, but in the years to come, their role would diminish under the thrust of the rising number of aggressive stock life companies, which totaled 93% of all companies by count in 1983. The population growth had shifted from the established cities to new centers in the west, southwest, and south. New life companies sprang up there. People began buying alternative products, due to a consumer preference change from ordinary life, limited payment, and endowment plans, to term plans and term riders, with considerably reduced outlay. The slogan "buy term and invest the difference" was still in the future, but the trend was there. So was the trend to better educate and better finance the new agent, as the cost of settling the new producer into production activity rose. Also, the cost of this process rose, and recruiting methods became less broad-scale and more selective.

The period of 1945-1965 also witnessed the greatest number of newly licensed companies reported. During this period, the total number of companies doing business in the U.S. doubled. Many were started by salespeople with innovative marketing ideas who previously had little association with internal home office operations. Data processing began to make an impact on the business, allowing companies to greatly increase the number of transactions they could handle.

From 1965 on, the combination of data processing's technological advances, innovation of product, inflation, the rising cost of selling insurance products, the decline of the debit business, the focus of the agent on higher income prospects, produced the principal alternative to the traditional agency system. As George said earlier, there are basically two systems: the other one is direct selling, direct mail, or simply mass marketing. Insurance did not lead the way in this trend; it followed. It became interwoven in the change of buying patterns of our country. It was greatly boosted by the rise in all products sold by direct mail solicitations or by catalogues. And then in the early 1970's, the higher cost of gasoline and its scarcity for a time, rising prime rates, the trend of convenience purchasing, broader communication forms, more government concern for protecting the consumer, truth in advertising regulations, the money-back guarantee, and the explosion of credit card services, all combined to make this new marketing form acceptable to the public. Mass marketing, an infant in the late fifties, growing rapidly in the sixties and seventies, is now on its way to maturity as the dominant new factor in insurance marketing for the balance of this century. Mass marketing of insurance did not spring to sudden birth, but is part of the evolution of all of the phases of the insurance industry which I have traced for you today. It is deeply rooted.

Mass marketing has been directly influenced by group insurance and its offshoots of wholesale, association and franchise. It is a lineal descendent of the debit form updated to today's needs and utilizing today's communication resources. It is the beneficiary of the level of desirability and respectability which insurance has attained with the general public.

Part of the success of the mass marketing of life insurance is timing. Attempts have been made to sell insurance by mail since the beginning of this century. But, it has taken the growth and acceptance of the direct marketing industry generally where virtually any product and any price range is available on a direct basis and insurance has become a part of it. My company wrote its first mass marketing plan in 1964. At that time, we believed that $5 a month was about the maximum an individual buyer would spend. As you well know, we have no such limits today and we're selling $100,000, $150,000, and $200,000 of life insurance; we're selling all kinds of health products by direct mail. And some companies that offer combinations of these products are taking as much as a $1,000 a year in premium from an individual prospect.

What are our prospect parameters? Let's surmise the general population can be divided into three categories. First, the lower income and non-income groups are best served by county, state, and federal government. Second, the upper and middle upper income groups are best served by the individual insurance producer who is trained and educated for this market. He or she is probably a Chartered Life Underwriter or a Chartered Financial Consultant and has the knowledge of wills, trusts, taxes and estate planning and is better equipped to sell and serve than any agent in history. And third, the great middle of the population which ranges from the upper fringe of the lower income level to the lower level of the upper income group, are best reached and best served by mass marketing. The objective here is market segmentation, and the proper utilization of it by the most logical sales or service unit. That's not just my evaluation of it. Two years ago, the newly-elected president of Mutual of New York, Henry Romaine, told The New York Times:

> "We pretended to hit primarily at the upper income market which is less a market for direct mail and where the talents of the individual agent can be most beneficially used."

What Mr. Romaine said points the strength and the weakness of the agent system. By maximizing time and talents, and by concentrating on the best possible group of prospects, much of the population is unserved or at least underserved.

Mass marketing has a heavy reliance on the mail services and our postal salesmen work hard for little pay. We also have a new type of collection system replacing the old debit; namely credit cards. The combination of the U.S. Post Office and the credit card system backed by toll-free numbers, WATS lines, mailgrams and the computer is unbeatable. The effects of mass marketing have already set in. A study by the Life Insurance Marketing and Research Association, which Mr. Joseph represented, was released in June 1981. It showed that in 1980, the number of households where at least one member purchased an insurance policy rose to 15% from 13%. The number of people buying in a household went up. During the same thirteen year period, the number of housholds reporting a purchase of insurance from an agent dropped almost 1/3 from 33% to 23%. The number of people who indicated they granted an interview to an agent during this period is startling; it dropped from 69% to 39%. Some of the industry leaders speculate that this situation is due mostly to the rise of new distribution systems such as mass marketing. Mass marketing of insurance products is no longer a wave of the future; it's a wave of the present.

How do we, as mass marketers, reach that great middle group? In a variety of ways. We can go to the prospect by mail, telephone, TV, or by cable. We can go by advertisments and inserts in newspapers, magazines, or any combinations thereof. We can go through seminar selling and multi-employer trusts; we can reach out through unions or clubs, through fraternal, alumni and professional associations, through mutual funds, department stores, drug stores, and supermarket chains. We can go through charge accounts or credit cards, through statement billing of gas, electric, water, and telephone companies. The list goes on and on as does the market. But, in reality, there is no such thing as a market; certainly not one market. It is a series of market segments or pockets or niches in the vast opportunity we generically call a market. There is the business and professional segment, the senior citizen, the college student, the saver, the spender, the estate and tax planning prospect, the frequent traveler, and many, many more. Actually, a person can be a combination of two or more or even all of these categories.

What are the characteristics of a proper market segment? It should have a commonality sufficient to logically bond it together -- large enough to make it worthwhile, affluent enough to be able to pay, healthy enough to be insurable, reachable, undersold and have a need for insurance coverage. This leads to the second part of my talk, which is about women as a marketing segment, as another alternative market source. Does this grouping fit my description outlined above? It represents 53% of the adult population in our country -- more than 85 million women. In 1950, women constituted 29% of our workforce, which grew by 1980 to 43.4% and will be close to 49% by the end of this decade. Occupation by occupation, women are taking over. Women now are experiencing a higher percentage of total income from past pay adjustments. They are experiencing greater employment and, interestingly, less unemployment.

The only way for women to go is up the executive ladder. Yes, women can pay and will pay for insurance products and will be even better able to pay in the future. How about this thriving market of increasingly employed people? Is it already oversold with life insurance? We all know better than that. Why haven't women been larger purchasers of our products? There are many suppositions, but insurance is a product that is sold, not bought. We haven't really energetically and enthusiastically asked women to buy. Even female agents have historically tended to sell to men and, in a large part, have been trained to go after the same market as male agents do. Do women recognize a need for insurance products? They do and they show it. During the period of 1968-79, women demonstrated this by doubling the number of their insurance policies from 10% to 20% of total policies sold. According to LIMRA, a recent study in 1981 showed that women purchasers rose to 33% of all sales. As I said earlier, this increase is without our genuinely trying to make those sales. I should also point out that the face amount and premium size of life insurance policies for women are generally less than half of those sold to comparable male groupings. The one women segment which has been covered is wife insurance. Most of these sales are for tax or estate planning or income replacement as homemakers.

How about females other than wives? The number of family households maintained by a woman with no husband present increased from 11% of total family households in 1970 to 15% in 1980. How's that for an alternative market segment?

It's against this backdrop that the Women's World Financial Corporation, the company I am now head of, was formed. Women's World is a holding company with two active subsidiaries at the present. One is First Women's Life Insurance Company, a Florida-based life insurance carrier, that was licensed on March 23, 1982. The other subsidiary is the First Women's Sales Corp., a specialized recruiter, trainer, supervisor and sales developer. A third subsidiary, focusing on non-insurance financial products, is expected to be activated later this year or early next year. As you might expect, Women's World will utilize mass marketing techniques in both its recruiting and selling. It will also carry forward the agency system in a blending of distribution systems. There are currently more than 2,200 life insurance companies licensed to do business in one or more jurisidictions of this country. But, First Women's Life Insurance Company will be different from all of them. As you know, women are typically insured today at rates calculated on the male rate less a setback credit based on the company's own plan, which might range from as low as a zero adjustment to as high as a seven-year adjustment. First Women's Life Insurance Company is basing its policy forms on the 1980 Commissioner's Standard Ordinary Table. Gross premium will also be based on female mortality.

In addition, First Women's Life has adopted language and benefits particularly designed for women and primarily sold by women. Our principal product is the universal life type plan. Certain special and unusual benefits are payable to women, married or unmarried. And the contract is available to all occupations, including the one dreaded by most insurance companies -- housewives. Great care has been used to make the policy readable with high Flesch test scores. We believe that this is a historic first --that nowhere in the history of the insurance companies, traced back to the 1700's, was such a company with policy forms, benefits, philosophy, staffing, and field force founded. We plan to sell in three basic ways -- brokerage, mass marketing and a career force. It is this last category that will be developed by First Women's Sales Corporation. This organization will seek to build a primarily female sales force similar to those selling cosmetics and health and household products, only this time selling the financial products -- initially life insurance.

Most will start part-time, so there will be no disruption in their present lives until their ability to successfully sell our product is established. Most will not have insurance selling experience, so that we will be responsible for their indoctrination and development. Women's field forces are now actively at work producing significant results for such organizations as Mary Kay, Avon, Amway, Tupperware, etc. But can a women's sales force succeed? Can women really sell insurance? We only have to look to Japan to get the answer to this. Since World War II, women have played an increasing role in life insurance sales in Japan and now represent more than 85% of the field force there. Japan, incidentally, according to the Life Insurance Fact Book, leads all countries in the world in the ratio of life insurance in force to national income and is really closing in on us in a lot of the other areas.

Our initial product, the Women's World, is but the first in a series of policy forms designed particularly for women and sold primarily for women by an organization staffed with women in most key positions. It is not a policy form we are selling as an adjunct to another market, but a break from the past -- an insurance concept, which in totality, has never been developed and successfully marketed before.

The life insurance industry in the United States is basically sound and has borne the rigors of change well. It has, since its founding, gone through wars, both foreign and domestic, and competition from other financial products, and shown an almost steady growth, year after year. According to the A. M. Best Company, on December 31, 1981 the industry had over five trillion dollars of life insurance in force and over five hundred billion of admitted assets. For the years listed, going back to 1880, there has never been a decrease in premium income, or in assets. This shows an industry remarkably adaptive to change and one which absorbs the changes and continues to move ahead. One year's alternative becomes another era's norm. Yet, all of us look back on our own careers, our own time spent in the industry, and we see the changes. We all adapt to the changes and absorb them and keep moving ahead to the new generation.

MR. ZEFFERT: We now have time for some questions. I have a few myself, but I defer to the audience.

QUESTION FROM THE FLOOR: What do you think is the long range future of Personal Producing General Agents (PPGA) companies? Initially, it looks good for a company to go to PPGA, but what do you think the long term prospects are?

MR. JOSEPH: I believe that there is a future for good, well-managed PPGA companies. We will see some merging of PPGA companies. The most difficult problem is the ability to recruit good field officers, who can recruit agents from good career agent companies. The career agent companies will become stronger and keep their field force more at home as they get into the wide range of products that many haven't previously had.

MR. LLOYD K. FRIEDMAN: Mr. Crohn, what are your company's contingent plans if unisex rates become law?

MR. CROHN: We certainly expect that to happen and we expect to benefit by it in two ways depending on how it comes into being. If rates are to be based on each company's own population of insureds, we will certainly have low rates, because we have mostly female insureds. If we were required to have rates at about the same range as other companies, we will, and in addition, we will have more benefits than others will be offering.

MR. ZEFFERT: I have a question for both of these gentlemen. What do you see happening to compensation patterns over the next ten years?

MR. JOSEPH: I'm going to quote Jim Leach, who does all of our compensation work. He feels that the overall commission rates for universal life have gone up 22% since the first universal life commission rate came out because that's what they had to do to get agents to sell it. We are seeing these things happening:

1. Some companies are beginning to give new agents a longer time to become successful, thus investing more money up front and using whatever kind of financing plan they have.

2. Some companies are experimenting with salaries by paying level commissions on new products but not on the old products.

We will see commission structures with some level amounts. The front end load will disappear. The only reason it hasn't gone yet is that companies have been afraid to do it at once. This must be done gradually until a whole generation of agents is brought into the business with more of a level commission basis. And obviously there is going to be some fee work in the upper income levels, but I don't think there is going to be as much fee work as we read about today.

MR. CROHN: In order for us to keep or increase our share in the market, the high/low commission has to go, because the industry can't survive against others when a hundred percent or more of the first year dollars that people pay go into sales. It is a highly ineffective method and is completely out of line with any other financial services industry. We are facing this in First Women's Life as we are selling a universal life type policy. We are paying a different commission scale, a far lower scale on the basic policy and a far higher one on term riders. We're encouraging our people to buy this policy with a very high cash fund and at the same time put a rider on it, so the salesman can get paid for going out and making the call. I'm sure there will be many companies doing things of that nature in the future.

Incidently, I think that this is going to be a problem that PPGA companies will face, especially in how they can spread out commissions, as cost and expense controls become more important.

QUESTION FROM THE FLOOR: Do you think companies will go to more expense reimbursement to agents to combat the brokerage problem?

MR. CROHN: In New York state, we have a very strong trade association, where members meet regularly and discuss their problems. This is one of the problems that comes up with regularity. The big accomplishment we've made in New York is in abolishing Regulation 49 and in the changes in Section 213 and the elimination of the onerous provisions there. Companies that are generally resisting it are being pressured with decreased persistency and increased costs everywhere. Some of the changes have been in allowing agents, who have their own headquarters outside of an agency and are producing substantial amounts of business, to be reimbursed more by the company. But, general agents are only rewarded for increased production. The higher their production, the more bonus points go to them.

MR. ZEFFERT: Many of the agents I know feel that companies have become less dependable when they commit themselves to agents. I think the gap between managers and the agency management and company management and their field has widened much too much. We're in the same business and somebody has to work a little harder to get back to it.