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## INDIVIDUAL HEALTH INSURANCE

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1. Some insurers market a broad portfolio of individual health products; others specialize. What considerations should guide decisions as to product portfolio, marketing objectives and distribution systems?
2. Products designed and totally administered by one company on behalf of other "client" companies, through the media of partial or total reinsurance contracts or company-wide brokerage or general agency agreements are becoming increasingly common. What are the considerations involved in this approach as a possible tool in competitive strategy?
3. What is the effect of increasingly severe rate and loss ratio regulations on individual health surplus and margins and on product and marketing decisions?
4. What is the impact of new federal tax legislation on individual health margins and profits?

MR. ARCHER L. EDGAR: I view the individual life and health insurance industry in the United States as having two distinct distribution systems, agency and direct response. While buyer response to nonpersonal solicitation, i.e., advertisements, etc., is gaining acceptance, agent-initiated sales are still preeminent in the life and health insurance industry and account for over 90% of all sales.

The agency distribution system is the network of agents or producers that include:

1. Life-only agents - captive or independent
2. Casualty agents who also write life insurance and who may also be captive or independent
3. Other firms with client relationships such as real estate agencies; automobile dealers, stockbrokers and funeral directors.

The size of the system is affected by recruiting of new agents or sales outlets and survival of the incumbent organization. In the last 10 years, recruiting of agents has declined while contracting of other outlets, such as stockbrokers, has increased.

LIMRA estimates that at the end of 1982, there were 241,000 full time exclusive agents in member companies distributed as follows:

Ordinary Agents	116,000
Debit Agents	81,000
Multiple-Line Exclusive Agents	44,000
(Over 50% of income from property and casualty)	

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This reflects an overall decline of about 8 percent since 1978 with the decreases coming in the ordinary and home service companies and increases in the MLEA companies.

Agent production patterns are predictable. Research data indicates that the number of policies an agent places with his or her primary company plateaus within a few years of hire.

This plateauing in number of sales means that a new product will be sold at the expense of some other product already being sold. That is, the new product is not an add-on but displaces an existing product. Thus, a stagnant or shrinking agency force and flat per-agent productivity have significant implications for distribution strategies.

To summarize:

- A. At this time, the insurance industry is served essentially by the agency system. A portion of the system is semicontrolled (captive); a part is independent.
- B. All companies using this distribution system have access to the same pool of agents to a greater or lesser degree.
- C. In the short run, the number of agents in the system is relatively fixed.
- D. The system can be expanded only by infusion of new blood, i.e., by recruiting agents or contracting new outlets. Thus, while the individual company can increase its own field force by hiring another company's agents, that practice does not increase the total agent pool.
- E. A new product is not an add on sale but displaces an existing product.

Distribution strategy is the particular option that a company employs in marketing its products. The company may opt for direct response, agency system, or both. It may distribute its products through producers with whom it has an exclusive selling agreement, or it may develop a full line of products and offer them through the pool of available producers.

The important difference between the industry and the company can be stated as follows: for the industry, the number of sales outlets is fixed in size in the short run; for the individual company, the number of outlets (distribution capacity) is theoretically unlimited. Thus, company market planners must view the agency system as a totally independent entity, standing apart from and independent of the companies, i.e., a common resource available to all companies. This concept is consistent and useful, even for companies that develop exclusive sales forces, for it puts into clear focus the wholesaler-retailer relationship between companies and agents and underscores the concept that companies market to agents.

Let us now evaluate the set of circumstances that have impacted distribution strategies and how companies have responded.

Economic Environment

Inflation and high interest rates have impacted the cost of doing business, the interest assumptions of the traditional whole life product, and of course, the cost of health care.

Information Explosion

Consumers and agents have been bombarded with information on attractive alternative uses for their money such as IRAs, CDs, Money Market Funds, and Cash Management Accounts.

Technology

Computers have shortened transaction time, crediting of interest, and design of complex products.

Regulation

Regulation and differential tax treatment prevent the operations of free market forces creating temporary product shortages. For example: universal life was first marketed by stock companies only; variable life still marketed by only three companies; difficulty in getting health products approved in some states.

And now let's examine some of the industry responses:

- A. Product Diversification - Redefining the mission of life insurance companies from risk protection to financial services.
- B. Client Control - Manufacturing or arranging to provide all the products a client might need through the same agents (full financial services).
- C. Distribution Diversification - Supplementing the career life agency system with sales forces such as stockbrokers and real estate agents and the opening of kiosks and sales outlets in grocery stores such as the Kroger experiment.
- D. Specialization - Separating manufacturing and distribution channels and recognizing that distribution is a profit center in its own right.

Let me briefly discuss the interaction of some of these forces. High inflation and interest rates created a demand for products that provided a hedge against inflation. Agents needed products that were compatible with their training that would keep them afloat until the parent companies adjusted to the environment. As a result, they sold term and annuities and whatever other interest sensitive products were available. The reinsurance market was very obliging.

After the favorable IRS ruling on universal life, they had a product that was interest sensitive. However, structural and legal problems (stock-mutual) created a time lag during which the product was available from only a few companies. While some companies waited for universal life to go away, some were trying to level the playing field, and others were positioning for full financial services and client control.

In the interim, the sales force drifted without any real leadership, help, or direction. Where there was a vacuum, innovative manufacturers, mainly

small stock companies, stepped in and provided the products the agents wanted and developed some interesting ways to serve the agents. So far, they have only been life and health companies. Don't be surprised if other types of manufacturers begin to exploit the distribution system -- reverse strategy -- you sell your products through realtors; when will H&R Block come after your agents -- good marriage isn't it?

Some marketing organizations specializing in mobilizing agents, marketing a single product, and providing many of the services that companies used to provide through their own field management, have emerged. Some are product specialists, others are process specialists, but they filled a vacuum and are now a force to be dealt with. I speak of brokerage GAs, managing GAs, and other marketing organizations that were once associated mainly with term and substandard business.

I do believe that their growth might have already peaked because I believe that, at this time, manufacturing and distribution is getting back into sync as agency building companies are now manufacturing the needed products for their agency forces or making arrangements to get them for their agents. Also, the reinsurance market is getting more realistic.

The most significant outcome may be that those companies that build or acquire delivery systems will view their agency forces as separate profit centers. They will exercise more control over this asset, and will make it available at a price, as a product conduit for other insurance companies.

The beginning of that practice is evident today in formal home office to home office agreements between companies that specialize in product development and those that own distribution systems. In these arrangements, the agency-building company acts as a general agent for the product company earning overrides with which to offset some of its costs for developing the sales force.

LIMRA recently surveyed its membership to determine the extent of such client-company arrangements. The results are shown as follows:

Manufacture/Distribution: The 204 reporting companies were divided into three groups - Canadian companies, U.S. companies with \$1 billion or more ordinary insurance in force (as of 1/1/78), and U.S. companies with less than \$1 billion in force. One fourth of the companies have arrangements to distribute the products of some other company or companies. Among the U.S. companies, larger companies are more likely to have arrangements than are smaller companies.

<u>Company Group</u>	<u>Number Reporting</u>	<u>Percent with Arrangements to Distribute</u>
Canadian	35	23%
U.S. Large	61	30%
U.S. Small	<u>108</u>	<u>23%</u>
Total	204	25%

Eight Canadian and 43 U.S. companies reported that they are "Manufacturers".

Nine of the U.S. manufacturers have products distributed by more than one

company. One company is particularly active as a source of disability income products.

Health products are most frequently the product line sold by distributors and have a longer history of distribution arrangements. The health products involved are almost exclusively disability income products.

Company Group	Product Line Sold by Distributors			
	Health	Group & Pension	Life	Annuities
Canadian	4	0	0	1
U.S. Large	8	3	6	2
U.S. Small	<u>14</u>	<u>8</u>	<u>7</u>	<u>5</u>
Total	26	11	13	8

Products are sold under the name of the "manufacturer" company among 85 percent of the reporting "distributor" companies. In one third of the distributor companies, the agent deals direct with the manufacturer. In the remaining cases, the distributor plays what is essentially a "general agent" role. These activities usually include paying commissions and may include submitting applications, transmitting policies and collecting premiums. In some cases a brokerage agency may be the vehicle for this arrangement.

Shopping Service: In a somewhat similar vein to the company-to-company agreement for specific products are the efforts of companies to assist producers in the placement of business that the company cannot accept. Nine companies have brokerage agencies to perform this function. Two companies have arrangements with brokerage firms to place the business that they could not accept. Other companies have special units in the home office to arrange for placement of business. This is exclusive of any efforts that a home office underwriting department might make through reinsurance agreements.

Now let me talk about the outlook of insurance distribution. With fewer agents, and flat agent productivity, competition for the agents' business will increase not only from the parent company but from the product companies. The product companies will be called on to share the cost of distribution by paying overrides to the distributing company. This will cause the profit margin of the product companies to decline and their products to increase in price to some market place - determined equilibrium price that meets the criterion of a viable product.

Products that require sophisticated training and special NASD licensing, such as variable life, will be sold largely by captive agent forces. Furthermore, as products become more service intensive, and regulated, exclusivity will be more and more crucial because control will be necessary where accountability is mandated.

While some companies will try to manufacture all products, many will make arrangements to have products available to their sales forces from specialist manufacturers. Such arrangements have existed as broker dealerships for annuities, mutual funds, and disability income. There is little need for a company to be all things. What is needed is to be compensated for distribution when a company "owns" the distribution arm. This is necessary for the survival of the system.

One fairly safe rule is that if the product is scarce, broker it; if it is complicated and process intensive, you need to control the distribution system.

The distribution environment is getting competitive. Distribution will not long be a "freebie". The system is costly and the companies that have invested in it are beginning to flex their muscles.

For those companies that have been getting a free distribution ride, this is one more element that they will have to put into the pricing formula. I believe that we are beginning to embark on the leveling of the distribution playfield.

I realize that my remarks have had a life insurance flavor. The two products have traditionally been distributed by the same agent. Therefore, it is difficult to keep them separate. But at the moment, there is more action in the life area than in health. The important point is that sales of the products are interdependent and what affects one is often reflected in sales results of the other. Remember, new products are substituted for each other, not added on.

The strategy for the industry is to separate manufacturing from distribution. So far, only insurance companies can be manufacturers of insurance products so we have an advantage. We also have the distribution channel.

The distribution system chooses products from among manufacturers. Let's dismiss the notion that we can force products on them. If they choose to sell gold or pork futures, it will be their choice.

It is a fallacy that only the insurance industry has a client relationship with the consumer. Our advantage is that we have a personal relationship through the sales force. So our competition is with entities that have distribution systems where there is personal contact with the client-stockbrokers, realtors, accountants, H&R Block.

In the final analysis, the agent remains the key to life, health, and related insurance product distribution. The system provides employment for approximately one quarter million individuals who work full time at selling insurance products. These individuals enjoy their careers and are satisfied and optimistic about their future. More than 50 percent have more than five years of insurance selling experience with their present companies. For them, this is a career, one that they will most likely continue to pursue. Thus, predictions of an agency system dropping to 20,000 agents in the next 5, 10, or even 20 years are without merit.

The agents have survived despite the prophets of doom. They have survived because they continue to view the insurance career as being the best choice for them. But the promise of the system is the freedom to be in business for ones' self. That presupposes the right to service a clientele and access to products either from a primary carrier or other manufacturer. The client, by all accounts, is satisfied and values the agent's service. The company unquestionably needs the agent.

With all three critical actors (agent, customer, and company) recognizing their basic interdependence, the agency system will survive. But the companies that will survive are those that can articulate marketing strat-

egies that will provide a profit to the manufacturer, profit to the distributor, value to the customer, and a living to the agent.

MR. THOMAS J. GRAF: I must admit to some confusion regarding whether The Bankers Life markets a broad or specialized portfolio of individual health products. Evidence that it is more specialized in nature stems from our decision to stop selling individual medical expense insurance as of January 1, 1982. Also, we have arranged for a reinsurer to take over the administration of virtually the entire block of existing business. At the same time, we made a new commitment to market a competitive disability income portfolio.

The disability income portfolio which is to be developed, however, will be quite broad in scope. It will include both personal disability, all occupation classes, and business disability uses including salary continuance, overhead expense, buy-out, and key man.

Also supporting the idea that we intend to market a broad portfolio of health products is the current consideration of a national account or company-wide brokerage agreement for medical expense insurance.

A little background about The Bankers Life will help in analyzing some of the reasons for the actions we have taken. The Bankers Life offers a full range of group and individual products. 1981 premium income by product line suggests the relative financial importance of each line. Group life, \$117.9 million; group health, \$772.3 million; group pension, \$725.9 million; and group property and casualty, \$6.0 million; individual life and annuity, \$300.9 million; and individual health, \$17.5 million.

Also, each product line contributes realistically to surplus except the individual health line which has been consistently generating losses since we began selling it (and ignoring it) in the 1950s.

The marketing objectives of the individual line include (in part):

- 1) Marketing toward a target of middle and upper income levels; meeting family, business, and professional needs; and supporting this marketing objective through expert field training and home office support.
- 2) Recognizing the product and service needs of the insurance-buying public and growing by meeting those needs.
- 3) Supporting the principle distribution system of full-time career and brokerage agencies.

Bankers Life utilizes a multi-faceted distribution system which includes career agents, career brokers, regular brokers, and special brokerage organizations. Career agents have provided a steady increase in premium income from year to year. Thus, the fluctuating nature of the total individual line premium has resulted from the variability of brokerage sales.

Like other companies, Bankers Life has been very much affected by the recent environment: interest rate volatility; federal income tax uncertainty; and escalating health care costs. The reaction at Bankers Life was that major product changes were essential in every product line. This,

coupled with the relative lack of financial importance of the individual health line to the company, begin to explain the reason for a needed cut back of resources allocated to individual health, both manpower and systems.

With that background, let us examine some reasons for dropping our individual medical expense line at Bankers Life, for our renewed commitment to disability income, and for our consideration of the national account arrangement for medical expense insurance new sales.

Our medical expense product portfolio was suffering severely from the escalating health care costs and required frequent rate action. And increasing regulatory pressure was making that needed rate action even more difficult to obtain. Also, a new comprehensive policy needed to be developed and this represented a major effort in terms of staff time and systems development. It was evident that an additional amount of serious attention was necessary for this line of business. Without it, as we had already proved to ourselves year after year, no improvement in the individual health loss picture would ever occur.

From a marketing point of view, we were concerned about possible government encroachment on the medical expense market. Our products were not meeting the needs of consumers because of the relatively inflexible internal limits. Few of our agents were selling the products because they were not competitive. And even our own career agents who were selling medical expense insurance were brokering it with other companies. In addition, there was the element of self-competition with our relatively large block of group health insurance being sold in the small group market.

The lower commissions normally paid on these medical expense products also seemed inconsistent with our objective to support our primary distribution system through career agents and career brokers.

There were reasons to continue to offer the individual medical expense line, of course. Primarily, dropping the line was not consistent with our objective of meeting the needs of the insurance-buying public. Also, however, we were unhappy about losing agent loyalty by forcing them to broker the medical expense business with other companies.

Our disability income investigation met with many of these same problems, but the decision was to stay in that market. We had been assured by various leaders in the industry that a profitable product portfolio could be designed. Experience had been improving since the 1970s, and reinsurance arrangements were available to help control the risk.

Our marketing people felt that disability income is an essential product for life insurance marketers because it covers virtually the same needs as those defined for life insurance. The market was deemed to be very large and virtually untapped. Also, the self-competition element with group income replacement coverages is not as substantial as with medical expense because most of the group coverage is short-term rather than long-term disability. Finally, disability income is a good product to help upgrade the target market because of its attractiveness to professionals and other high-income buyers.

We already had a viable distribution system in place, ready to tap, since many of our agents were brokering disability income with other carriers.



Also, continuing the disability income line was consistent with our marketing philosophy of supporting the agency system. It is perhaps an easier sale than life insurance for a new agent, and it offers both new and experienced agents the opportunity to increase productivity through multiple sales to each client. Additionally, we sought to enhance the brokerage premium production which had trailed off in the last few years.

There were good reasons to consider withdrawing from the disability income market. A new portfolio of products was needed along with the staff, systems and field training to support it. The high and permanent cost of this development, coupled with an uncertain profit picture for disability income and the need for major efforts in other more financially-significant lines of business made the decision very difficult. However, the marketing need for disability income was the deciding factor.

Currently we are considering a national account arrangement for individual medical expense insurance new sales, mainly to retain agent and customer loyalty. Some of the advantages of this alternative will be apparent in the discussion which follows.

My main involvement with the individual health portfolio of The Bankers Life began after the decisions to drop medical expense insurance and develop disability income had already been made. I'd like to spend the next few minutes discussing the alternatives for the disability income development which we considered after my assignment to individual health. These were: 1) national account, 2) client company, 3) our own portfolio with reinsurance. Below are some of the considerations which led to our decision to develop our own portfolio.

The cost, risk, and profitability picture of the three alternatives varies considerably. Development of our own portfolio required the greatest investment, most substantial risks, and yet offered the greatest profit potential. The national account arrangement required very little initial investment, and very little risk taking, but offered a much more limited profit potential. The client company arrangement falls somewhere between the two alternatives on all three counts. Risk and profit are shared through the reinsurance agreement.

Control of the product, including product philosophy and flexibility to meet competition-driven changes, was a very important element to our career field force. Obviously, development of our own portfolio was the most responsive to our own needs. However, substantial control can be retained through use of a national account arrangement as well because of the ability to move in and out of these arrangements with some ease. The client company arrangement on the other hand, offers the least control and flexibility because the product design is controlled by the host company, and the ability to terminate the arrangement is limited by the need to amortize the substantial initial investment.

Regulatory and legal problems are generally not significant when using a national account arrangement. With your own portfolio, these problems are clearly your own. However, the client company arrangement raises some questions in both areas. Since the products being sold are really those of the client company, all regulatory compliance is the responsibility of the client company. Of course, much of the compliance work can be performed

by the host company, but the client company is still responsible. As for legal problems, it is interesting to consider who is responsible for damages assessed to the client company which arise from actions taken by personnel of the host company. In the sample client company contract I reviewed, the host company relieved the client from any legal liability which might arise from the host's actions under the contract, and vice-versa.

Substantial staff and systems development is necessary to offer a portfolio of products on your own. There is virtually no such investment if a national account arrangement is used. At first-blush, the client company arrangement might seem to be more similar to the national account arrangement for this purpose. However, we were surprised at the size of the marketing staff needed to market your own products through the client company arrangement. Likewise the systems development was more than we expected. This was primarily because of our desire to have control of records which would at least summarize the block of policies for which we were responsible, and because of our desire to integrate our client company products into our existing framework for agent and management compensation.

The primary advantage of the national account arrangement is in the speed with which a company can move into a market and back out when necessary. The client company arrangement has a longer lead time in getting in, and perhaps a problem in moving back out. Obviously, development of your own portfolio is slow and must be considered a permanent commitment. Of great concern to us at Bankers Life was the lack of control over service to customers and agents inherent in the national account and client company arrangements. Indeed, this may have been one of the most compelling reasons to choose development of our own portfolio since a forte of The Bankers Life has always been its ability to provide service.

Finally the pride and loyalty that only the development of our own portfolio could command permeated the opinions of customers, agents, senior management and the employees of Bankers Life. Each group of individuals has always been proud to be a part of The Bankers Life family. This pride had been fostered by the products and services offered by the company and its agents, as well as the general attitude of the company in dealing with its publics. Almost every group surveyed felt that our disability income product should have Bankers Life's own stamp on it, and this could only come from the development of our own portfolio.

MR. CHARLES W. KRAUSHAAR, JR.: In 1980, New York Life faced the decision as to whether it should remain active in the individual health market. In reaching our conclusion that it was financially feasible to do so, we made decisions as to product portfolio, marketing objectives and distribution systems. I will be telling you some of the considerations that led to these decisions.

As a background, let me describe the circumstances leading up to our deciding whether to remain in the individual health business.

As far as disability income plans were concerned, like many other companies, we had experienced the adverse financial experience in the mid 1970's. As a result, sales in the lower income and blue collar markets had virtually been discontinued. In addition, our portfolio of disability plans had not been kept up-to-date and because of a lack of residual disability plans and other newer developments, many of our agents, particularly those selling

in the higher income, executive-professional markets were brokering their business with other companies.

With regard to medical care, the now discontinued CHIP plan and other comprehensive-type plans had captured the imagination of the more successful agents who brokered them freely. Although we did have hospital and major medical policies that sold moderately well in the lower income market place, particularly in the South and South-West, agents clamored for comprehensive medical expense plans.

In general, our agents were disappointed with our portfolio. As a result, a lot of business was being brokered. Management, on the other hand, was concerned about the financial losses in disability income, and the investment required to develop a comprehensive policy and its financial viability.

As further background, let me tell you a little about New York Life. A large mutual life insurance company, New York Life works on a Branch Office system and has about 8 thousand active agents -- more Million Dollar Round Table agents than any other company. Our primary line is individual life insurance, although we also sell group life, health and annuity, and individual health and annuity.

We started writing individual health insurance in 1951, and have always written both medical care and disability income. However, most of our business is medical care.

In order to determine whether to remain active in the individual health business, we first decided on what a competitive individual health portfolio should include. In making this decision, we took the position that our agents were our market. And so the portfolio included the plans that they had indicated that they wanted to sell -- so long as we felt that they were financially viable. After determining the portfolio we then set realistic sales assumptions. These were based on historical data as to the percentage of agents selling health insurance and the average number of sales per agent. Combining the two, and including the other items which would normally go into profit studies (such as morbidity, expenses, etc.) plus the additional start-up costs we felt we would incur, we determined expected financial results. These were favorable enough to convince management to go ahead.

At that time, since we had an 8 thousand-agent field force, we did not spend much time on decisions as to distribution systems in the conventional sense. However, we did spend time reviewing how we were going to convince our agents to sell individual health products and, for those who were already selling them, how we were going to wean them back to selling New York Life's individual health products.

Let me assure you that this is a most difficult job, particularly in the disability income market. Many brokerage supervisors of other companies have convinced our agents that they are "experts" in individual health insurance. It is to the brokers' financial advantage to have our agents continue to place their business with them. They will fight hard for the business by furnishing sales assistance and other inducements.

In addition to competition from the outside, there is competition from the inside. New York Life was divided itself into a number of product centers

which are in competition with each other for the services of the same set of agents. Each product center is engaged in trying to sell its own products. For example, in November of 1981, three different products were introduced: a yearly renewable term life program; a deferred annuity program; and a disability income program. Each program was actively promoted by the product center that developed it. The term and annuity programs got a lot more attention than the disability income program -- which would be expected from a field force which is oriented towards individual life insurance -- and it was not until the second quarter of 1982 that disability income sales began to pick up. The heavy emphasis these days is on new products -- universal life, and tax deferred annuities to name a few -- this can impact on sales of other traditional products.

Under the circumstances, we did not think that the ordinary sales promotion and training methods would be sufficient to achieve our sales assumptions. So we added regional sales consultants -- 10 of them -- to promote individual health insurance and train agents. These consultants are housed in the field and make regular trips to all of the general offices in their region. In addition, we will soon be furnishing additional sales assistance through an automated proposal service for disability income plans. We think this is a must.

We have made a considerable investment particularly in recruiting and training the regional sales consultants. We are seeing some results in terms of improvement in the quality of our business. We are selling more of our disability income business in the markets that we prefer. Also, for disability income plans there has been considerable growth in the average size premium and improvement in persistency. On the other hand, we have not yet seen growth in the number of sales. A few of our consultants have been in place for almost a year, most only a month or two. I do not believe that they have had an opportunity to fully impact yet.

In concluding to stay active, we felt that delivery of a good product with good service to the Field was critical. As I mentioned, practically all individual health activities, actuarial, underwriting and claims, are now included in one profit center, under one head. I feel that this is imperative if you are going to compete with companies that specialize in health insurance.

As far as product line is concerned, both disability income and medical care made sense to us because these were the products that our agents were selling and wanted to continue to sell.

Disability income is a compatible product for life insurance salesmen. However, it is a very competitive market, especially if you plan to sell to the higher income executives and professionals. This means a constant effort to know and stay with the competition in product and underwriting rules. However, as history has proved that a company can lose a lot of money in disability income, since underwriting results can be affected by a variety of factors ranging from the acceptance of poor risks to economic changes. Therefore, the business has got to be constantly monitored and prompt action taken if experience warrants. New York Life has not always done this in the past. However, we now have developed monitoring systems that allow us to do so. For example, we can monitor the business of individual agents and, last year for the first time we discontinued the accep-

tance of business from a few agents who appeared to be working in undesirable markets.

Medical care is a difficult product to develop and manage these days. When a respected competitor pulled out of the comprehensive market, we were right in the middle of developing a comprehensive plan of our own. We immediately reassessed our position. On the one hand, this respected competitor, was pulling out of a product that it, for all practical purposes, had developed. On the other hand, other competitors seemed to be marketing comprehensive plans with some success.

Our own experience with major medical plans made us aware of the absolute necessity to stay on top of medical care rates as far as premium increases were concerned. Upon review, our conclusion was that we had included all of the appropriate safeguards and that comprehensive was a viable product, at least for the near term. Management approved our recommendation to go ahead and we introduced our plan last October. Prior to introduction, management were concerned that we would lose money. After introduction, our agents are concerned that our premiums are too high. So far, sales have not been up to expectations. However, activity in other lines has been substantial and we just introduced a universal life product. Or, it may be just the result of switching from a relatively inexpensive, non-area rated product to a higher cost area rated one. That is, we have switched markets and it will take our agents time to become accustomed to the fact.

A final point on product. New York Life's field force is not an homogeneous group. We have neophyte agents just starting out, mature agents who have been around for a while, and the "stars" who sell very large amounts of insurance. It is our philosophy to try to have a product -- not necessarily all products -- available to the various types of agents included in our field force. Our products range from the simple non-underwritten hospital indemnity policy to the sophisticated products for the high income executive-professional.

Let us move on to the considerations involved in using products designed and totally administered by one company on behalf of other "client" companies. It has become very expensive for us to introduce a new product. The big area of expenses is not the development or pricing of the product but the electronics costs. In addition, programmer time is at a premium. Requests for programmer time are prioritized and those that do not get top priority are postponed, sometimes indefinitely.

Recently, we were looking into a product which we did not believe would have sales sufficient to justify its development by itself, but which we believed would be attractive to round out our portfolio -- that is, to reach a market which we were not currently penetrating and, perhaps attract additional business in other markets. And so, we looked into having the product administered for us by another carrier.

A major advantage is that you avoid the expense of developing the product and can request priorities for programmer time for other jobs. Another advantage, I assume, is that the administering company not only gives you a product but keeps it competitive and up-to-date. One major disadvantage was that you were buying the same "off-the-shelf" product that other com-

panies were using, the only difference perhaps being the name of the company on the policy. Of secondary importance were underwriting and claims practices. No two companies are alike in these, and differences between the practices of the administering company and your own could irritate the field force. Of course, this difference in practice would not exist where a company had a third party administrator handle its entire line. Finally, of course, one shares the favorable financial results with someone else. If you have the resources to do it yourself and the market to justify it, in my opinion, you are better off to do it yourself.

Incidentally, to me this is just part of a larger picture. Expense considerations are limiting staff and other resources. On the other hand, competition requires new products and product changes. As a result, companies are increasingly using outside agencies for what was formerly done solely in-house. For example, we are using consulting actuaries to assist in individual health product development where we do not have the staff to do a job ourselves. This is the first time, to my knowledge, that this has been done at New York Life.

MR. E. PAUL BARNHART: We thank all of you panelists for all the work you have done. Would any of you on the panel like to throw a question at one of your fellow panelists?

MR. KRAUSHAAR: Arch, suppose a company's agency force has been invaded by a specialty product company. In order to restore the asset value of that agency force, it is necessary to get rid of the specialty company and wean your agents back to your own products. How do you do it?

MR. EDGAR: There is no easy answer. The one good thing that's going for the insurance companies is the fact that most agents prefer to have a primary relationship with one company. I don't think agents want to drift around, because the more business they place with their primary company the more money they are going to make. For example, the State Farm Insurance Company prohibits its agents from brokering other companies' products, yet they have the highest survival rates of any company in the United States. They've got maybe 50 percent of their agents surviving after 4 years. And the average income for their agents is in the \$70,000 to \$80,000 range. The company, in return, promises the agents that it will not allow other companies' agents to sell a State Farm product.

Some companies are going to flex their muscles by pulling out the computer and overhead support if their agents are not selling their own products.

The agency companies have an investment in the distribution system. There's got to be a way in which they can collect some money for that investment. The client company arrangement is a good development since some of the client companies are the product manufacturers and are happy to pay some of the overhead. And I think this is going to be the way for a while.

MR. BARNHART: We would like to have some discussion from the floor. Who would like to make a comment or ask a question of one of the panelists?

MR. RONALD M. WOLF: I would like to ask Charlie a question. If you felt there was a need out there for other types of products that the agents don't want, how would you handle that? Also, is there any way that indi-

vidual health insurance products fit together in the big picture of consolidation of financial services?

MR. KRAUSHAAR: There are products the agents want to sell and they are unequivocal about it. If an agent wants a comprehensive policy, you will not satisfy him by a hospital policy plus a major medical. On the other hand, we have, on occasion, put out products that agents have not asked for but have been quite successful. I would expect some resistance for the more complex products unless they could really catch fire such as some of the life products have recently.

Regardless, you have to get the support of your agency force behind you. Otherwise, it will not sell no matter how good it is. I think Arch and I share a common feeling that we get our products to the public through the agents, and if they don't push them through to the public, they will not get there.

MR. EDGAR: I don't have a lot to add. I just want to pick-up on the full financial services question.

I do see some products like the group health insurance products that could provide some synergy in the small proprietor market place. I am not aware of any company that is targeting full financial services to anyone but proprietors. I think the Connecticut General and the Travelers will be looking at the small business owners.

QUESTION FROM FLOOR: Arch, you mentioned a survey that you've recently taken that describes companies activities in the client company situation. I was wondering if Charlie and Tom could comment on the companies' situation.

MR. GRAF: We considered the client company arrangement for this disability line but decided not to go that way.

MR. BARNHART: Tom, what about the medical insurance line?

MR. GRAF: It is more a brokerage arrangement.

MR. KRAUSHAAR: We don't have any such arrangement.

MR. BARNHART: Charlie, had your company ever seriously studied that possibility?

MR. KRAUSHAAR: We did consider it for specialty product, but not for the entire line.

MR. BARNHART: I would like to ask Tom and Charlie a question about viewing that individual health line as a profit center.

I have had many clients who have indicated that profit is the only reason that they considered the individual health line. But others have mentioned other considerations such as agent development and keeping agents from brokering other companies' products.

I think when a company goes into a new product or a new line, there may be other considerations as important as the profitability. But a few years

down the road, I see a steady gravitation toward "Is this line making any money or isn't it? If not, should we stay in it?" I wondered if you could comment on the way your company looked at that.

MR. GRAF: I think in the long run there would be the type of scrutiny that you are alluding to.

If we continue to generate losses, the management would want to review it. But I don't think the decision will be solely based on the profitability.

I really think that in order to have any chance at all in being profitable in the long run, we have to develop a profit center within the company just like most of the industry leaders have done.

MR. KRAUSHAAR: We have a stated corporate policy that we are not going to have losses and that our products must be self-supporting.

However, we were unable to go ahead with this policy because of the sensitivity of assumptions for demonstrating that it would produce a viable financial result.

MR. BARNHART: Tom and Charlie, both of you have referred to profit centers. In viewing it as a profit center, does that mean you have an entirely separate DI or Health Department handling all the aspects of administration?

MR. GRAF: I think the concept of a profit center would be that all functions are handled within that profit center. We felt that we needed to have control of the marketing, actuarial, underwriting, and claims functions as a minimum. We are taking a kind of wait-and-see attitude on other administrative functions.

MR. KRAUSHAAR: We are virtually in the same spot. Obviously, it is not practical to put certain functions, such as EDP or Legal, under one roof. We definitely feel very strongly that we must have our own underwriting and claims resources. We have our policy contract changes, actuarial research and compliance functions all under one department and under one person who is responsible for results.

MR. EDGAR: I would like to direct a question to both Charlie and Tom, and also to people in the audience who might have some experience with this. Both of you have looked at the possibility of client companies and you've chosen not to go that way. I am wondering, did you get as far as to find out whether or not you could make enough money on it to help support your agency system?

MR. KRAUSHAAR: I think there are two keys. First of all, you have to have the resources in the first place. Secondly, but most important, the sale volume must be significant to be worthwhile for the investment.

MR. GRAF: In looking at the client company arrangement, when we did it we felt that we could meet the costs of our agency system; but I'm not sure of the development costs.

MR. EDGAR: Well, I was just curious to know whether or not there was something that could help support your system or could help amortize the cost of building your sales force.



MR. BARNHART: Let's get into question number 3: "What is the effect of increasingly severe rate and loss ratio regulations on individual health surplus and margins and on product and marketing decisions?"

I think Charlie has a few comments on the effect of rate and loss ratio regulation.

MR. KRAUSHAAR: I'm not sure I know the increasingly severe rate and loss ratio regulation that is being referred to: I always thought it was severe. Perhaps the reference is to the new modifications in New York's regulation 62. I think that regulation is unfortunate in that it affects previously issued contracts. As a matter of principle, I believe it is unfair to add additional requirements for previously issued contracts. I'm also personally uneasy with that regulation because credibility standards have been set with no theoretical justification that I know of.

Although I am not sure that I fully understand all of the ramifications of this regulation, I do not believe that the regulation will have a serious effect on New York Life.

Rate regulation in the Medicare Supplement field, though, has had an important impact. New York Life offers a Medicare Supplement plan without evidence of physical insurability. We do have some limited underwriting rules such as requiring that the applicant be covered by both parts A and B of Medicare and have no other coverage, but these are minor matters. With normal commissions, I can meet a 60% loss ratio requirement with this policy but not a 65% requirement. Meeting the 65% requirement requires a fairly substantial reduction in commissions.

Originally, I was reluctant to market the product generally in states requiring a 65% loss ratio because of the lower commission on the assumption that sales of this non-underwritten product would be small with too much opportunity for anti-selection. However, the product proved much more popular than I anticipated and so we are marketing it generally in the 65% states with the reduced commission scales.

As far as other rate regulations are concerned, we find them more annoying and requiring more work than we think appropriate, but they are not adversely impacting on the Company, yet. I would point out that New York Life's recently introduced comprehensive medical care contracts are "non-renewable for stated reasons" because of the very remote possibility of capricious rate regulations.

MR. BARNHART: Thank you Charlie. How many of you in the audience represent companies where loss ratio or the whole spectrum of individual health regulation has been the direct reason for making any basic product or market decision? (Several hands raised.)

The most frequent complaint I hear isn't so much the levels of loss ratio guidelines and requirements, although those have certainly been of an increasing concern as they shot up to 60% - 65% or so, but the increasing variety of requirements. Many companies feel that doing policy filing and obtaining approvals have become increasingly time consuming. The perception I get of this is that it is this increasing variety that requires more and more attention from the lawyers, the actuaries, and the compliance officers. For how many of you has that aspect become really material or critical?

MR. BRUCE R. DARLING: The impact that we're finding is that on health products, as opposed to life products, in our pricing we have to price for minimum loss ratios.

We would like to be able to price by being able to build the appropriate margins for expenses, overhead, distribution costs, etc., like we do in our life products, and then look at the competition and whatever other considerations. Instead, we're restricted to a particular gross premium level that is dictated by the minimum loss ratio standards.

Now it gives us a lot of problems when we have a variety of loss ratio standards in different states yet we have one product and we feel uncomfortable with having different price levels in various states just based upon their particular minimum loss ratio standards.

MR. BARNHART: Have you ended up actually coming out with different rate levels.

MR. DARLING: Occasionally we have ended up developing an entirely new product for our best states and then using an older product in the other states that had other requirements.

We really wish there were some other way of regulating health insurance premiums. We never have life minimum loss ratio standards at all.

MR. THOMAS C. FOLEY: We've been in the medical expense business for a long time. The variety of regulation is very onerous. Would anybody comment on where all this is going?

MR. BARNHART: Where I see this heading is that as more states adopt rate filing guidelines with seemingly minor, but significant, variations, that most companies are increasingly having to prepare a whole set of different filing documents.

I tend to worry a little for multi-state companies that 10 years down the road they may have to prepare 40 different rate filing documents for 50 states.

Sooner or later federal regulation may become a feasible alternative.

Okay, we have one final topic here. Let's turn briefly to the question of the impact of the new federal tax legislation on individual health margins and profits. We are going to turn again to Charlie for a few remarks.

MR. KRAUSHAAR: Let me start out by saying that I am not knowledgeable in this field and my comments reflect the studies that others at New York Life have made -- with the hope that these comments will stimulate other discussion.

For a large mutual life insurance company which was in Phase I and is now in Phase II, negative, the result of the new law is to tax gains instead of NII (net investment income) after required interest where gains are on a net level reserve basis, and 77.5% of dividends are allowed as an expense item.

Effects on our comprehensive medical expense program, which is attained age rated and has a 10% level commission, are clear. Profitability is reduced, since all items are taxed, rather than just NII.

Our disability income portfolio is level premium with a front-loaded commission scale. As a result, there is a large before tax loss in the first year, which is substantially diminished by the new tax law. The asset share turns positive a year or two earlier than previously, but again our asset shares show the ultimate profitability is lower. On the other hand, under the new tax law, losses, should they occur, can be partially offset by taxes.

Under both the new and old laws, dividends reduce profitability and margins. Under the new law, however, both effects are less severe, due to the partial deductibility of dividends from gains. Although we currently pay dividends under some of our older individual health policies, we do not pay or illustrate them for the contracts we are currently issuing. Consequently, dividends are not reflected in the previously mentioned results.

MR. BARNHART: The current new federal tax legislation is an interim tax law. I'm wondering how many of you are waiting to see what shapes up as a more permanent situation, and how many are adapting or adjusting to the current tax situation?

MR. WOLF: Currently, the Administration is proposing a cap on group health insurance premium that an employer can deduct. Will that have an impact on individual health products? Will it create some new markets for supplementary type individual health products?

MR. BARNHART: Because of that, some employers might simply limit the amount of money going into group plans in such a way that might reopen the individual health market as a supplementary type of coverage.

