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## INSURANCE COMPANIES OFFERING NONINSURANCE PRODUCTS

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The noninsurance diversification question is addressed from the following perspectives:

- . Principal motivations
- . Potential areas of diversification
  - Mutual funds and other consumer investment products
  - Computer services and software
  - Real estate investment and management
- . Diversification issues
  - Manufacturing and distribution compatibility
  - Management capacity
  - Risk
  - Who is better served?

MR. JAMES E. JEFFREY: This morning we heard some excellent discussion of the environmental factors driving change in the financial services community. I call these the six "D's"; distribution, disintermediation, demography, deregulation, data processing and diversification. Together these certainly do spell competition both within and from outside the insurance industry and if you are a life insurance company you cannot help but respond.

Your response might be active or passive. Passive responses could include do nothing and wait for normalcy to return, give up and get out of the business or consolidate. There are two major categories of active response. First, the "stand and fight" response; compete vigorously in the present business on the basis of price, product, distribution, specialization, marketing approach, promotion and other methods. The second active response; diversify your product offerings beyond insurance or even beyond financial services.

Our panelists bring a variety of perspectives to the diversification response alternative. Our first speaker is Mr. William Potvin. Bill has a degree in International Economics and an M.B.A. and he started his business career selling combined life insurance/mutual fund products. He joined GEICO as an investment and financial analyst, playing a significant role in the turnaround of that operation.

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For the past five years, Bill has been with Touche Ross and Company and has worked closely with the actuarial profession in consulting with insurance organizations and financial services industries in Canada, the U.S. and in Europe. Those consulting assignments have focused on strategic and organizational planning and control, venture planning, product design and operations improvement.

MR. WILLIAM T. POTVIN: Thank you Jay. I would like to talk today about some of the issues facing the insurance industry, the products that we are offering and the ways that the insurance industry can respond to the challenges posed by the new competition.

The rapid dramatic changes which are occurring in the financial services industry are causing insurance managements to raise some critical questions about the products they are offering and the markets they are delivering them to.

First, do we need to consider offering noninsurance products and services? The new competition is changing the product focus of the insurance industry. Competition from the broader financial services markets is forcing the restructuring of our products. A significant opportunity exists for insurers to increase the returns on their greatest asset, the relationships with the "served market", that is the customers that they serve. The rapidly changing financial services market is requiring new services to compete.

What is a non-insurance product? In fact, what is an insurance product? Insurance companies have traditionally bundled service around risk oriented products. The traditional, fully bundled, whole life insurance product is made up of several components; an asset accumulation or savings product, some risk protection, and processing and service. Both financial and nonfinancial organizations have forced the unbundling of insurance products and are competing for the components. The consumer has become much more rate sensitive and sophisticated in his choice of product. Consumers will not unlearn the new sophistication that they have picked up. Today, we are in an environment where competition from a variety of institutions is nipping at the components of the traditional insurance product. Banks, brokers and savings and loans companies are after the asset accumulation component. Insurance companies and now banks, are going after the risk protection component. Brokers, S & L's, and service bureaus are going after the processing and service end.

Which of these are noninsurance products? Or are they all insurance products? Is the insurance industry only capable of delivering the risk protection product or is it capable of also offering savings and asset accumulation, and processing and transaction services to its customer base? If we take the narrow definition that insurance products are risk based products and that savings products and transaction based products are not, there is a problem. If insurance companies do not compete for the noninsurance components of their products, the competition may capture the most desirable portion of their business. The industry may lose its share of consumer assets and, as a result, the relative cost of the risk protection product

will increase. We will have a much smaller base over which to spread the fixed cost of delivering these products to our customers. Unbundling requires the development of new products which can compete head on with those offered by other financial institutions. The asset accumulation, risk protection, transaction and administrative services can no longer be packaged for a single price, but rather their components need to be able to respond to the competition from the banks, the brokerage firms, savings and loans and others.

The second argument for expanding into new product areas is the opportunity to meet what I would term "served market needs." An insurance company's greatest asset is the customer relationships it has developed with the served market, i.e. the customers that it has, serves and knows. In 1981, the insurance industry invested over \$18 billion to find and develop relationships with those customers. Six billion dollars was paid in commissions by the life insurance industry, \$12 billion by the casualty companies and much, much more in additional marketing and customer service expenses, for the one real purpose of finding and developing relationships to deliver financial services to individuals and businesses. Our existing relationship with a broad vast market is a significant competitive advantage in delivering services. We know who our customers are, we know their characteristics and needs, we have access to them, we have their recognition and confidence and last, but by no means least, the cost of getting to those customers is much lower because we are already there.

Insurance companies are often among the first financial institutions to establish significant relationships with customers. The young family-forming individuals entering the market are developing relationships with our companies before they buy their first home, develop their credit line or do more sophisticated banking. A company that is limited to delivering a narrow range of products cannot take full advantage of the customer relationships it has paid for.

Most market segments buy a broad range of products and services. They do not just buy risk protection, they buy a whole variety of financial and nonfinancial services. More significantly, each customer's needs change and grow during his life. In a number of studies, we have found that the insurance buying public tends to be the younger, family-forming individuals. Beyond age 35, individuals purchase much less of the life insurance products and much more of financial planning, asset accumulation, retirement and similar products. Broadening services to meet more of the needs of the served market will make more efficient use of an insurance company's investment in its customer relationships and allow it to be more competitive. One of the reasons that insurance companies are having trouble competing is that they have not capitalized fully on the amount of money they have invested in the customer relationships.

Broadening services will prevent noninsurance companies from establishing competing relationships in our served market. The competitive financial services environment requires new service

responses. Other financial institutions are responding to the needs and competing for the served markets by networking together to offer a broad range of financial service products through a single customer service relationship. We are seeing an accelerating trend toward networking, for example Prudential-Bache, Shearson-American Express, Sears-Dean Witter. Sears and American Express are relying on their credit card customer bases as the single customer service relationship through which they are going to be focusing their services. Merrill Lynch-Bank One established the common account on which they are focusing their services. Thompson MacKinnon, a brokerage firm, has announced the purchase and development of a relationship with a group of savings and loans. We do not have to have all services going through a single relationship, but a selected number of services could be efficiently offered through various vehicles aimed at the customer.

There are two potential roles insurance companies can play in this new competitive environment; the institutions which control customer relationships or the suppliers of service to the network. In order to succeed in merging financial services roles, we will have to have certain characteristics in the industry. Those succeeding as controllers of the customer relationship (probably the most profitable and clearly the most desirable) need to have strong existing served market and customer relationships, efficient distribution systems and strong technological capability to integrate services. New technologies are not shaking the industry because they are novel and new, but because they are giving the industry the capability to integrate services, a significant advantage to the buying public. Success in the alternative role, that of service supplier to the network, will require low cost producers that have flexible and innovative products and the technical capability to interface with the network.

If insurance companies are to maintain their role as a controller of customer relationships with the markets that they currently control, they will need to develop new products and services, better communications and information services to integrate products, and up-grade their technical capabilities. They will need new products to meet the needs of each served market, either internally developed or externally networked. There is no reason why insurance companies cannot network and get services, savings, transactions, credit cards and financial counselling services to the extent they do not have them internally in the organization. They can network with other organizations to deliver them to their served market, maintaining control over that customer base.

Broadening services will make insurance companies more efficient, and the competitive environment is requiring it to meet new needs which the market is demanding.

In working with financial services organizations, we have developed a planning approach which can help companies decide on and select which services they ought to be offering to their markets. We have dubbed it a "Served Market Planning Approach."

To select products and services which a financial service organization will offer, efforts should be focused on a company's market place. Who are their customers and what will the company be to them? By selecting the market segments an organization wishes to serve and choosing what it will be to those markets, a company can better control its profitability, its growth and perhaps its long term survival. Most traditional planning approaches are focused on product and functional lines. Product life cycle approaches and product matrices which segment our products into cash cows and rising stars were developed and are useful for the industrial, technological environments. They have a limited applicability in the service industries.

Served Market Planning develops product and service strategies along the needs of a specific set of customers or served market. Products and services in the financial services industry can be easily and quickly duplicated. Universal Life came out in the insurance industry and in a matter of months some hundred companies were offering it. The advantage is not in the products that we have, but rather in the customer relationships that we have developed and invested in, and this cannot be duplicated easily or quickly by competing institutions.

There are four steps in the Served Market Product Planning process. The first three steps are aimed at determining the types of services the organization can deliver and the fourth deals with the specifics of the products that it might want to deliver at any given point of time.

#### 1. Assessment of the Market and Competitive Position of the Company.

Here we ask a number of questions to inventory what we can do. Where are we really competing today? Who are our customers? What market segment have we been successful with? Who are our major competitors in our market place? What are their strategies? What environmental, regulatory and technological forces will influence our ability to compete for those market segments? What resources do we have at our disposal? We must then consider what we can be. What alternative served markets make sense? How can we serve those markets better than our competition?

#### 2. Development of Served Market Objectives and Strategies

We need to get very specific in terms of which new markets and products and customers we want to serve. Where do we wish to go? Are there geographic boundaries? What types of services will we look at offering over a period of time? What is the nature of the distribution system which we have available to us? We need to set goals in terms of market penetration, and we need to identify the financial performance that we expect to get out of these activities.

#### 3. Identification and Development of "Infrastructure" Required to Serve Selected Markets

After we know what can we be and what we want to do, we have to

realize that no single strategy is going to get us there. What alternative product, service, delivery and operating scenarios are compatible with our objectives and competitive position? Which strategies or scenarios are acceptable to the organization? What long and short term infrastructure requirements are common to the acceptable alternatives? What do we really have to build in the organization in order to preserve the largest number of options and the greatest flexibility? If, for example, we take a technological strategy, we may not know which system we need to build tomorrow but we need to know that we must today build up and bolster our data processing capabilities, head office processing as well as automated distribution processes. Human resources, product support, systems communication, distribution, and management control all have infrastructure requirements that will allow us to follow a variety of scenarios in the future.

4. Development of an ongoing process to assess the immediate needs of each served market.

What products and services are customers buying now? What are our competitors offering? What services will fill a need in our served markets? What resources and responsibilities must be in place to quickly respond to the served market? How can we be sure that we are the first to offer the products and services that meet the immediate needs of our market? A strategy that says "Five years from now we are going to be offering a product group that is 25% banking services, transaction and credit card, 32% universal life, 10% financial counselling" is going to be wrong. We need to position ourselves and posture ourselves to be able to take a variety of roads, the common element of those directions is the needs of the market place that we choose to serve.

Market needs, regulation, and competitive products change constantly. Success is not picking the right next product but being able to respond to a customer quickly enough to maintain an exclusive customer relationship. A good example was the money market funds. Most insurance companies did not offer them and did not respond quickly with new money products. Enormous amounts of the insurance industry's capital and asset base was siphoned off into another industry. If the insurance companies had been there with that new product and had had the infrastructure in place to develop and offer that product quickly, a much lower erosion would have occurred.

Finally, what are the management implications of expanding product offerings in our served markets? The ways we have done things in the past will need to change. The distribution channel serving the customer increases in importance. New capabilities and new technologies are emerging and they are going to have to be dealt with. The need to move quickly to respond to competition increases. The products and services we offer must be tailored to the needs of different served market segments. Because more products draw on the cost centres in our insurance companies which serve a given market, the pricing and profit monitoring needs to vary by market. Different

markets use different levels of service for the same product. For example, an up-scale market may use the loan features on a policy much more frequently than another market segment, requiring greater service and costs. Behavior varies by market segment, in terms of the amount of service and the number of transactions that the segment demands. Different markets have different levels of price sensitivity. Organizations will need to develop a market rather than a functional focus.

Making change in existing organizations is risky and difficult to accomplish, but the risk of doing nothing may be having nothing to do.

MR. JEFFERY: Our next speaker is Ron Abrahamson. Ron is also an M.B.A. and has spent virtually his entire 15 year career with IDS, the majority in marketing planning and research. For the last two to three years, however, Ron has been doing corporate strategic planning and development at IDS and his current responsibilities include orchestrating IDS's strategic planning and competition analysis processes as well as participating in some merger, acquisition and joint venture activities.

MR. RONALD G. ABRAHAMSON: In this "case study," I will address the what and the why of IDS's activities in noninsurance areas. The focus of my remarks will be IDS rather than IDS Life. Although life insurance and annuities are our major source of earnings today, IDS Life is one of several "product providers" within the IDS Group. IDS strives to act as a single enterprise rather than as a holding company with relatively autonomous subsidiaries.

To provide a frame of reference, let me give you some background about our company. We are a moderately large company, headquartered in Minneapolis, but owned by New York based Alleghany Corporation. Our origin was not in the insurance business. We started out in the savings certificate business in the late 1800's and were one of the pioneers in the mutual fund business in the early 1940's. By the time we finally started our life operation in the late 1950's, we had become the world's largest fund and certificate complex. Until the late 1960's, all of our products were sold through a single delivery system, our career agency force.

In the late 1960's, we entered a phase of rapid and extensive diversification - but all separate from the sales force. We bought or created operations in such diverse areas as consumer lending, mortgage banking, leasing, institutional securities brokerage, municipal bond underwriting, real estate investment trust and pension management. However, by the early to mid 1970's, problems had developed, primarily due to the large amount of short term debt required to support most of these new operations. When the credit crunch came, disenchantment set in and a "back to basics" strategy was adopted. Except for the pension management business which leveraged our traditional money management skills, (and did not require debt), all the new ventures were disposed of.

In addition to the turmoil caused by these ill-fated diversification moves, our sales force went through a painful transition during the 1970's.

## PANEL DISCUSSION

	<u>1969</u>	<u>1978</u>	<u>1982</u>
Sales Force Size	4353	2857	4114
Total New Sales (billions)	\$2.0	\$1.9	\$4.7
Mix of New Sales			
Mutual Funds	69%	18%	28%
Certificates	10	10	24
Insurance	13	41	18
Annuities	8	29	26
Other	<u>---</u>	<u>2</u>	<u>4</u>
	100%	100%	100%

At the end of the 1960's, the sales force was selling primarily mutual funds and was flourishing in both body count and productivity. We hit an all time high in 1969 in terms of both total sales and the total size of the sales force. However, a poor environment for equities in the 70's increased competition from no-load funds and new legislation which changed the tax status of our certificate product all impacted negatively on the sales force. Survival required that our sales people become adept at selling insurance as well as investment products. Because of the massive reorientation required, this took considerable time. The sales force deteriorated for most of the 70's, while a more balanced needs-selling or financial planning strategy gradually evolved and we began putting the necessary infrastructure into place. A turnaround was achieved and the sales force is currently flourishing. As we made the transition from a mutual funds company to largely an insurance company in the 70's, the mix shifted heavily into insurance and annuities, and by 1982, we are selling a very balanced product mix.

Today IDS manages over \$15 billion of assets for 1.7 million customer accounts. Life insurance in force totals over \$13 billion and 1982 net income was some \$63 million, of which about 80% came from our insurance and annuity lines.

Now, a bit about why and how we plan at I.D.S. Three years ago, IDS brought in a new president, Wally Scott, to help us move into a faster growth mode. Coming from Pillsbury, which is one of the few companies that still has not entered the financial services business, he brought a much needed consumer products background. Concurrently, we reoriented our planning process so that corporate objectives and strategy formulations, rather than financial projections, drove the process. We were determined not to repeat the mistakes we made during our diversification phase of the late '60's when an opportunistic, as opposed to strategy-based approach, was taken. Effective strategic planning would be critical for IDS to emerge as an industry leader.

Our strategic planning process is a fairly classical approach. We start with an appraisal of the external environment, as well as our internal strengths and weaknesses. That then feeds down into goals and objectives and the assessment of strategic alternatives. It is during this strategic planning process that diversification



opportunities are identified and assessed. This planning process is not merely a staff activity. The entire Senior Management group is involved, as well as the next level of management within each of our marketing and product areas.

How do we view the financial services market place? Diversification and strategic positioning have become the catchwords of the financial services industry in response to four major forces for change: 1) unprecedented competition from an expanded variety of sources, 2) uncertain and volatile economic conditions, 3) major advances in technology, and 4) the advent of deregulation.

Financial firms and delivery systems, sometimes independently, sometimes in unison, have each responded to these pressures. As a result of the fundamental restructuring of the industry taking place, financial firms have been finding it increasingly uneconomic to muddle along attempting to meet a single broad need in a broad middle market. In the past, lack of an ability to recognize and understand market needs might have slowed a company's product development and marketing efforts, but the company could still survive, protected by the regulatory barriers surrounding it's business. Those barriers are now eroding. In the future, relating effectively and quickly to the market place will be critical. Companies which merely emulate others, without focusing their efforts and without acting on a thorough understanding of their chosen markets and their own particular strengths and weaknesses, will be uncompetitive.

All financial services, whether purchased by individuals or businesses, satisfy one of three general classes of needs; cash flow management, risk management or investment management. Within either retail or business markets, most products serve a single need. All of IDS's current product offerings are directed toward meeting risk and investment management needs. In fact, our statement of corporate purpose defines IDS's business as "providing a variety of financial services, including financial planning, investments and insurance, to help individuals and institutions establish and achieve their financial objectives." Note that we do not define ourselves as either a life company or a mutual fund company, rather our corporate purpose focuses on the kind of needs we want to meet. We have no particular desire to manufacture products to meet cash flow needs, such as transaction and consumer lending services. These products are volume and technology driven and are outside of our areas of expertise.

We have some major strengths on which to build for the future. In addition to our product capabilities in the life insurance and investment management areas, our key strengths relate to our large nationwide customer base and, in particular, our unique, powerful and growing sales force which has an ingrained "needs-oriented" selling approach and experience and expertise in selling both investment and protection products.

Our corporate objectives build on these strengths while also addressing some weaknesses. We have a whole set of objectives addressing the increasingly important market orientation. These objectives all relate to our conviction that, where we choose to

compete, IDS must become more market-needs driven, dedicated to effectively segmenting markets, assessing and understanding their needs. We must have timely and competitive products, utilize efficient delivery systems and provide effective customer service. A market focus is indeed beginning to emerge, and in fact, we are currently in the midst of organizing the company around retail and business markets. The market orientation will drive everything that we do.

A second set of objectives are financially oriented. These place heavy emphasis on financial strength, return on equity and earnings growth, and set standards which are quite ambitious relative to our historical performance. Surviving, much less flourishing, in an increasingly demanding environment will require greatly improved results.

A specific objective, which is both market and financial related, calls for broadening and balancing our operations between retail and business markets and between fee-oriented and interest spread businesses.

Two additional sets of objectives relate to human resources and corporate responsibilities and not directly to product decisions.

Let us now look at IDS's portfolio of markets, products and delivery systems and see how our strategy, which includes a lot of nontraditional diversification, reflects our objectives, strengths and weaknesses and our view of the competitive environment.

Within the retail market, we are targeting our efforts at middle and upper income households, those earning roughly \$30,000 to \$75,000 annually, as well as very small businesses where the owner's needs overlap extensively with the needs of the business. Within targeted segments we will meet needs related to risk and investment management. Cash flow needs, to the extent they are met, primarily will be through networking arrangements with other, more transaction-oriented institutions. We have adopted a very integrated retail thrust, centered on, but not limited to, the IDS sales force. Where we do use other product delivery systems, such as direct response, it will be primarily for generating new customers for the sales force, and/or to leverage our products and customer base. The sales force's efforts revolve around delivering comprehensive financial plans and implementation products, of which life insurance is but one. IDS's representatives meet several times with each prospective client, first to collect data for analysing needs and later, to offer personalized plans for meeting the identified needs along with recommendations regarding specific products to implement the plan.

A wide array of products is available to our sales force and will be expanded. Currently they sell some 50 products, primarily from in-house product providers but also non-competing products obtained outside the IDS Group. The Home Office Brokerage Agencies have been established to swing deals with outside manufacturers and coordinate the offerings of non-IDS products necessary to support our financial planning approach. IDS-produced products include a wide variety of

insurance protection products, (individual life and disability, small group life, disability and health), single premium and installment annuities (fixed dollar and variable as well as group pension annuities), fourteen mutual funds (with different investment objectives, risk and tax characteristics) and finally, three different investment certificates (each available on a single pay or installment basis). Brokered products include several specialty life and medical insurance products, Aetna's tax qualified annuities in New York State where we choose not to write our own, Nuveen's Tax Exempt Bond Fund and several limited partnership tax shelters including Apache's oil and gas program and JMB and Carlyle real estate packages.

Generally, products offered by IDS, and particularly the manner in which they are offered, stress value-added. Although some simpler, more commodity-type products will be available, they will not be emphasized, rather they will serve as lead generators for financial planning services and sales of more complex products.

Reduced profit margins and commission rates have caused us to become increasingly concerned about maintaining and improving representative incomes. Our research indicates that an amazingly large number of middle and upper income households are receptive to use and pay for broad financial planning advice. Thus, while financial planning has been largely a sales methodology for us, we have begun to charge fees in a fairly aggressive manner and share fee income with our representatives for certain stand alone plan "packages." Unbundled fees for financial planning has significant long term potential to boost representatives and IDS's income and better meet customer needs. In short, we expect financial planning per se to become a major nontraditional product.

In addition to, but separate from, efforts in the retail market, IDS is serving the pension management needs of medium and large businesses. IDS Advisory was started in the early 1970's to enter an attractive new market and leverage our existing investment infrastructure. It has had an outstanding performance record and now is managing over \$3 billion in assets for some 100 clients. Also part of the Advisory Group is a Trust Company, started a few years ago, to provide various fiduciary services, as well as collective fund management for somewhat smaller accounts. The Advisory's services are marketed by its own investment professionals and pension specialists. Pension management is the only thrust we have in mind for the upper end of the business market. We are content to remain a specialty operation here. Because of formidable and entrenched competitors and because larger businesses have separate decision-makers to combine risk and investment management products, we were skeptical that Advisory's entree can be leveraged in non-related areas. However, we are attempting to broaden the line of pension-related services we provide. Last month we acquired Gray, Seifert and Company, a New York based investment management company. Utilizing an investment style that is very different from Advisory's, Gray, Seifert expands our involvement in the pension fund market as well as provides an individual investment management capability for more up-scale retail clients.

Although we believe we can achieve significant economies of scale within our current product lines and delivery systems, a strategic "gap" does exist between our objectives and the earnings capacity of our existing operations. Thus, additional diversification efforts will play an important role in our future. We are looking for opportunities that do two things: 1) allow us to capitalize on our existing capabilities and strengthen our ability meet the financial needs of our target markets, 2) have substantial growth potential and over the long term increase IDS's return on equity and cash generating abilities. In evaluating diversification opportunities, we address several questions. For particular products, is it in our best interest to be a distributor, a manufacturer or both? Using an existing delivery system, can incremental sales be generated, taking into account both product displacement, cannibalization, as well as sales force time or resource displacement? Does internal development, joint venture or acquisition provide the best means of entry? Some of the diversification alternatives we are considering in the retail market include real estate, securities brokerage, property/casualty insurance and financial reporting.

For the past several years we have brokered public real estate syndications for several companies. Now, to enhance our profitability, we have structured a joint venture with JMB to package a "private label" product for our sales force. To enhance our representative's client control in the more up-scale markets, we are experimenting with various securities brokerage formats. Due to some concerns that full-service brokerage may conflict with financial planning, this experimenting will initially only involve a minimum level of service and representative involvement, specifically selling securities at discount rates.

Personal lines property/casualty insurance meets a basic risk management need and could serve as a productive lead generator for the sales force. However, our current thinking is that personal involvement by our sales people would likely get in the way of their financial planning effort. We are exploring the concepts of selling auto and homeowner's insurance on a direct response basis.

A comprehensive financial reporting capability would support our retail market thrust. In addition to adding sales and assisting in updating plans, a good reporting capability could also increase the bond between IDS and our sales people. We are looking at various external linkages to Cash Management Account-type products as a vehicle around which a reporting capability could be developed.

In the business market, but largely separate from the Advisory operation, we see a potentially attractive opportunity to serve small businesses, those with 10 to 250 employees. These firms typically have a single decision maker, but are too large to be adequately served by the products and delivery system provided to the "business owner" portion of the retail market, yet too small to warrant the attention generally given to larger institutions. We envision delivering a broad product line probably including pension and thrift plans, group insurance and commercial property casualty insurance, to meet multiple needs of a client in an integrated manner. We also

envision utilizing captive sales people that are dedicated to this market. Depending on what proves feasible, members of our small business sales force may be either broadly-based generalists or individual product specialists who utilize a team-selling approach. We are just now starting to put some of these pieces together.

Summarizing then, I have tried to give you an overview of what we are doing at IDS in terms of products, markets and delivery systems. I have described our view of the marketing environment and showed how that view has influenced our "nontraditional" competitive responses.

MR. JEFFERY: Denis Loring is Assistant Vice President at the Equitable. He joined the Equitable in 1976 after five years with John Hancock in the Underwriting and Reinsurance field. Denis has a Master of Science in Mathematics and his current responsibility is Director of Reinsurance Operations.

MR. DENIS W. LORING: Why do we want to consider offering nontraditional insurance products? A broadened arena of competition in financial services, decreasing profits on traditional business, and the movement from risk products to fee for service products are three reasons. And of course, a standard buzz-word in strategic planning is the notion of distribution channels.

The Equitable has a career agency force distribution channel. We also have a rather unique distribution channel of the nation's reinsurance companies. Equitable is the largest retrocessionaire, that is, assumer of reinsurance from reinsurers in the United States. Our clients, in that sense, are the 20 or 30 reinsurance companies and their clients are the 1,750 life companies. We identified the served market of our reinsurance companies and their served market of insurance companies as markets for which we already had distribution systems in place. How could we take advantage of this?

Before discussing those markets, let me go to back to the traditional career agency force. We have a money market fund and a universal life product on a life account (and that provides a base to expand to a master cash management account which allows payments of insurance premiums, cheque writing, credit and debit). We also have a leasing company which leases equipment to doctors or dentists for their offices, doing that as a financial service.

As a bridge between financial and other services, consider the Equitable Relocation Service. This is a service that we originally had in-house to relocate employees. We have several major regional offices around the country and of course many branch offices. The employees had to be transferred or relocated, which means selling and buying a house, transferring mortgages, moving possessions, etc. That was an internal need and we had developed something to serve that

need. Obviously other corporations have the same relocation needs. Could we sell that service? We did. Equitable Relocation Service is now the third or fourth largest such service in the country. If this worked with Equitable Relocation Service, could it work with anything else we do?

What types of products do we have? There are reinsurance products, investment products, computer system products, (relating to asset accumulation, risk products and servicing), and of course there are consultant products, for the insurance industry and general management.

We started with reinsurance, a business we began in 1976. We have this network of reinsurers, and we are the third largest life insurance company in the United States, with a retention of \$10 million. We need that capacity ourselves and considered selling it to the outside world, the business of retrocession. Why not just set up a reinsurance company? That would require reinsurance salesmen! The Equitable agents are not going to sell reinsurance and to create from scratch a new field force is a very expensive proposition. Therefore, we chose to serve only professional reinsurers. We do life reinsurance, are looking to expand to disability income reinsurance, and someday we may go into property/casualty reinsurance.

The Equitable manages assets. That is one of our businesses. If we manage our own assets, we should be able to manage someone else's assets, so we are getting into the business of asset management. For example, a company wants to issue universal life but it does not feel it has the asset management capability to give the types of guarantees it needs, so it works with a reinsurer to reinsure the product, and that reinsurer works with us. We provide the asset management, the reinsurer provides the necessary reinsurance coverage and the direct writing company gets a universal life product.

We are beginning to put together a real estate limited partnership. A small life company may want to put \$1 or \$2 million into real estate, but it cannot get into a \$100 million real estate project, and that is where the big money is. It requires a very special type of expertise. We have it, we do it internally, and we want to make available to the outside.

Two names that you may have heard of with respect to asset-liability matching are Irwin Vanderhoof and Jim Tilley, both of whom work for the Equitable. We have what we believe is a "state of the art" asset liability matching system. It is a software product that is being made highly user friendly, and we will sell it to other companies.

We have a lot of group health business which we administer with Equi-claims, a system we derived for our own business, and which we figure cut our administration costs about 50%. There are other companies that would like to use a group health administration system, even noninsurance companies who are self insuring and willing to assume risk but not servicing. Equi-claims is available.

There is currently an unfulfilled need for a reinsurance administration system, so that a small company can issue its own

reinsurance cessions by typing into a terminal on its home base which connects to a reinsurer's computer. Cession papers will not have to go flying back and forth and be lost by the U.S. mails. We are working with that.

The whole notion of remote data entry, Apples in homes, banking at home, insurance at home, will be very important in the 1980's and 1990's. We have a remote data entry system for the field, so why not make it available to others?

We have developed other items for our own use. We have an Econometric Model, developed by a PhD in economics, that we use for our own forecasting. We have a specific insurance industry model that our competitive strategies area uses to try to plot what is going on with our competitors. We have some Corporate Planning and Tax Planning techniques. We even have a multi-variate persistency model which is a fairly sophisticated mathematical technique for analysing persistency.

Notice, we are slowly getting farther and farther afield from standard insurance stock. For management development, we have a questionnaire and a method of analysing it, that is useful for measuring the development and training needs of our managers, and we have a workshop program to assist those needs. Certainly, if consulting companies can offer it, we can offer it. We have a corporate effectiveness survey, which again is a customized questionnaire, and a method of analysing it.

"Staff Projection" is a computer program to assist in analysis of staffing needs, based on what you expect your company to be doing, and growth in certain parameters. It should help determine what sort of hiring is required, in terms of both agency force and home office personnel. Contiguous to that, we have an exit interview program. Why do employees leave? Obviously, agent turnover and home office turnover is a major problem. How can you gather information about that to help stem the flow? We have a program for doing that. Finally, there is retirement preparation, and we have a three and one-half day seminar where pre-retirees get together in small groups and do financial and psychological retirement planning.

Those are a lot of services and a lot of different things we can be doing. It may seem as though we are trying to be all things to all people. We know we can not, but it might be amusing to see how close we can come! There are problems in trying to do this, which I divide into the internals and the externals.

The foremost internal problem is commitment from top management, in the sense that you do not promise what you can not deliver. The C.E.O. must be willing to devote the resources of his or her company to serve the needs of people outside that company. Why might that be a problem? Self-competition. If our asset liability matching is so great, why do we want to give it to somebody else? Then they can compete with us. The standard answer is that eventually they will have it too, and in the case of many of these things, for example consulting services, if they do not buy from us, they will certainly buy from someone else. If they are going to get it anyway, we might as well get some fees out of it.

There are, of course, the additional research and development costs. It is much easier to prepare a product for internal use than it is to sell that product on the outside. You can get away with things internally, using chewing gum to stick it together. On the outside, if it does not work perfectly, the client who has paid good money for it, is going to come screaming! Can the market for any given product support those additional R and D costs? Remember these are additional R and D costs, not things that we are developing from scratch, but rather things that we already used inside the Equitable and are now trying to market outside. There are marginal costs to get them outside, not the costs of developing them the first place.

You must have a dedicated service staff, dedicated to serving the outside clients. They have to know the products that they are dealing with. Their sole function must be the service of those outside clients. If we have sold Equi-claims to Teenie Weenie Life and John Smith is a service agent, and Teenie Weenie Life calls needing help with Equi-claims, John Smith must not be saying, "Wait, I have a big problem here in the Equitable, I have to look after my own needs first, then I will worry about you..." This will not wash. John Smith has got to work for Teenie Weenie Life in this respect, and only for Teenie Weenie Life. Finally, if there is a problem with the system that John Smith sees out in the field, he has got to be able to go back to the Equitable and say "They have a problem. We have to fix it." He needs the clout inside, and this goes right back to top management commitment. It has to have been made clear, from the top down, that if you are selling products to the outside and those outsiders need service, service must be provided and the people inside who have the responsibility have the authority to get things done.

Then, there are the external problems. If you have all of these products to sell, how do you distribute them and does every distributor get every product? Some products are more amenable to exclusives, while some, the more commodity-type products, are more amenable to broad based distribution. Speaking of distribution, how do you compensate them? We know how you pay agents, but how do you pay a reinsurance company, for example, to distribute an asset liability system? Do you pay him a flat fee or something based on usage? If you are distributing a variable life administration system, do you take the service fee and let them get the reinsurance part of the deal? It has to be financially attractive to the distributor.

The distributors may not be as knowledgeable about the specific products that they are distributing as you are. Obviously, a reinsurance salesman is not going to know the ins and outs of Equi-claims, but he still has to know enough about it to be able to sell the product. You have the problem of making that person comfortable enough with your products to be able to distribute them and yet, not taking up too much time so that his own product gets compromised.

Again, the question of competition with the clients. Are you competing with the people to whom you are selling, and will they view you as competitors? Why should John Hancock buy something from Equitable and put more money in Equitable's coffers? The answer has



to be that these services will be bought, and the bottom line to a potential buyer is who will provide the best value.

In closing, let me say that I am in the life insurance business to make money. This business used to have the wonderful combination of high margin and risk. Now we are in a situation of low margin and risk, and that does not work too well. There are only two things you can do about it. You can shove the low margin back up to high margin and keep the risk, but I do not think the competition will let you do that anymore. The other alternative is to stay with low margin and eliminate the risk, moving from a risk product to a fee for service.

If, in fact, you are in the business of making money, it looks as though the traditional ways of making money are not working. You have to find another way. If you have spent your own company's money internally in developing a vast network of potential products and services, you might as well sell them to somebody else. Let those products and those services work for you and provide a new type of return.

MR. JEFFERY: Should insurance companies broaden their product offerings beyond insurance? We have heard from a professional management consultant who thinks that they should consider it very seriously. We have heard from a professional strategic planner who thinks so too, and his company is putting its money where his mouth is. And we have heard from an actuary who thinks so as well and his company is doing the same. What do you think?

