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GROWTH STRATEGIES FOR SMALLER COMPANIES

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o Impact of investment - oriented products

o Use of reinsurance

o Asset safety vs. asset growth

o Products maximizing positive cash flow

MR. JOHN D. LADLEY: Today, our panel will discuss "Growth Strategies for Smaller Companies" from their base of experience with Individual and Group investment products, money management plans and, fixed and variable products - including GIC's, Group Annuities, Flexible Premium Annuities and other products. We will look at this topic from a product perspective. We also have a variety of distribution systems represented here from group and pension representatives, to direct response on-site sales locations, and the general agency system. Our discussions will touch on the significant opportunities and challenges facing the smaller life insurance company in the planning, design, marketing, and control of an investment-oriented business.

The panel is divided between actuaries and non-actuaries. Mr. John Achenbach, an Executive Vice President of Manhattan Life Insurance Company in New York, is a business line manager accountable for the overall results of that company's investment-dependent products. His lines of business have grown from virtually nothing to over $300 million in assets in the past several years. Mr. Achenbach is also the Company's Chief Investment Officer. Mr. Ned Costello is the Life Product Director for Fidelity Mutual Funds of Boston, which currently have over $24 billion under management. He is responsible for Life product design and sales as well as marketing Fidelity's investment, cash-management, and other services to life insurance companies and other financial service companies. Mr. Ed Slaby, the other actuarial representative besides myself, is Senior Vice President/Finance for Unity Life, a $190 million asset mutual in Syracuse, New York. Unity has had considerable success marketing individual annuities, especially coupled with life insurance products, in the New York marketplace. Because his responsibilities encompass Financial operations as well, Mr. Slaby has also been deeply involved in various aspects of investment decision-making and actuarial issues. My name is Jack Ladley, and I'm a consulting actuary with Huggins Financial Services in Philadelphia.

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Each of these panelists will discuss growth strategies (and their implications) for smaller life companies, and after all are finished, we'll entertain questions and comments from the floor.

Why are we here today? It's clear to most of us that the traditional agency distribution system on which we depend has become increasingly expensive and difficult to control. The products we've traditionally designed and offered have become increasingly outdated as well, as competition broadens and grows. The natural growth strategy for most traditional, Ordinary-type companies has become marketing to the upper income, higher socio-economic classes. But to what extent can this strategy sustain all of us?

Many companies in recent years have therefore chosen what they believe to be profit potential paths to follow. Among them are increments to existing distribution systems such as entering direct response, movement into Group or health insurance and, finally, movement into investment products. It is this last area that we will take a very careful look at.

Each of these seems to be clearly a different business, with its own requirements, risks and rewards; entry into and success in each might seem to be no simple process. My observation is that the tendency is to think of these as related to existing markets and not very complex or difficult for life companies to enter. While they are related to existing life businesses, the growth track is often a difficult one to follow. Our panel is unusually well-qualified to discuss their experiences with implementing the investment growth strategy, in its various forms.

MR. L. JOHN ACHENBACH, II: As Mr. Ladley has indicated, my background is in investments, not actuarial practice. As I began to prepare for this meeting I must confess to a certain amount of anxiety, particularly since this would have to be classified as a sophisticated audience. But after I fretted for a while I recalled an incident with one of my staff which may illustrate the commonality of our interests. Some time ago I induced, without undue chicanery or slight-of-hand, a bright young FSA in our actuarial department to join my staff. His general mission was to work with us on our asset/liability management process. We had several discussions about his duties and prospects and we both agreed that the future of our company and the industry in investment-based products held interesting career prospects for someone with the quantitative skills of an FSA. In spite of this and his obvious interest in our area he looked mildly troubled and uncertain. When I probed this response - his direct answer was "I'm interested but I don't know anything about investments." While he was right on one level, he was dead wrong on another. My answer to him was "Yes you do. You are trained to analyze values of future cash flows in pricing products. Analysis of investments today deals significantly with evaluating present values of future cash flows and doing so under conditions of uncertainty as to timing, amount, and discount rate." Also I said "a function of a portfolio manager is to equate a client's asset and liability cash flow needs and objectives relative to his and her earnings goals." This actuary is fast becoming a very competent investment portfolio analyst.

I think that conversation says a great deal about how an organization must approach investment management of investment-based products and businesses.

Let me tell you another related story. In early 1979 our company decided to emphasize asset building products. I won't bother you with the rationale but I will note that our growth had slowed and our return on assets had followed suit. I joined Manhattan in mid-'79 to run our securities effort and to contribute to the growth of a new GIC-oriented pension fund investment business. My ostensible qualifications included several years experience as a fixed income portfolio manager with an investment counseling firm and a large money center bank. During this period I managed a group that advised commercial banks and other financial institutions on portfolio and funds management. In the course of a final interview with our chairman, to whom I report, where we were discussing bond portfolio strategy, I said something to the effect of "to structure the bond portfolio properly we should interrelate with the strategy being pursued by the mortgage officer and we both should construct our strategies relative to the company's sources of funds and its overall liability mix. How is this done now?" We talked generally how the industry was changing and these were becoming much more important issues and we would focus on them increasingly. That was in May of 1979. In October, Chairman Volcker struck and changed our business environment dramatically. In the aftermath of that October massacre our industry's policy loans hit new records and our long-term mortgage loan forward commitments at 10 and 11% didn't exactly look like winners. Needless-to-say, we began to talk and plan quite vigorously for disciplined asset/liability management.

Those were difficult times. But there was a brighter side, at least for our company - and I think this would be true for most smaller companies which are or which plan to pursue investment-based businesses more aggressively. At Manhattan, unlike many of our competitors, apart from our large block of ordinary business, we did not have much short duration annuity type business supported by long duration assets. We were able, almost from scratch, to develop asset/liability management strategies appropriate to our new businesses and the organization and systems appropriate to such businesses. The net effect of these circumstances has been the development of a managed balance sheet over the past few years where our assets and liabilities have a close functional relationship in terms of liquidity, term, credit risk, interest rate risk and so forth. In effect, that conversation in 1979 has become reality for us and has changed significantly our management process and positioned us effectively for the markets of the 1980's and 1990's.

Well this could be viewed as a rather general treatment of the subject but it points up a variety of basic issues that drive investment strategies focused on investment-based products of which GIC's may be the more simple variety. Let me list what I think are some of the major issues a management should address, not necessarily in order of importance since each company is different - marketing, pricing, investment strategy, surplus/capital, administration/systems, and organization.

Now that's what I call a full plate! Obviously we can't go into everything today and pricing is particularly out-of-bounds, or so our legal departments tell us. But what is particularly important to note is how tightly interrelated these issues are. Any investment strategy with investment-based products involves them all and each affects what you do with the other.

Over the past few years there have been various sessions, conferences, etc. sponsored by this Society and others dealing with many of these issues in varying degrees of depth and specificity. This week's meeting is a continuation of this process. What I will try to do is to relate to these questions in the context of our major interest-sensitive business segment - GIC's. Perhaps in so doing I may generate some thoughts as to modus operandi for the businesses at your companies.

A speaker at a Society meeting last year noted that a world dominated by interest-sensitive products required matrix management techniques. He was so right. And the corporate culture changes inherrent in effective matrix management I believe are critical to the success of investment product business strategies. Let me touch first on marketing mix - or the desired combination of product, price, place and promotion. Investment strategy and marketing mix are closely related and you can't discuss one without touching on the other. Our focus has been on pension-oriented products but is broadening increasingly to encompass other products and lines. Let's focus on GIC's. On the surface GIC's represent a relatively straightforward asset-liability management problem. Liability cash flows are highly certain and you can structure a duration-based immunization investment strategy. But wait a minute - are we talking only about single sum compound interest bullet GIC's or are there other forms in the product portfolio. Do you sell simple interest GIC's; or GIC's with installment payouts at maturity. Do you sell window GIC's or variable rate guarantee contracts. You may have all these and more. Your distribution system may be more or less effective with different contracts. You may want to broaden your distribution channels and this could affect your product mix and investment strategy.

Product mix and sales demand will vary with the timing of the business cycle and interest rate expectations. In a high rate environment you will be more successful with liability maturity lengthening via longer term GIC's; in a low rate environment marked by expectations for rising interest rates the converse will be more characteristic.

Distribution mix will be important for investment strategy particularly from the standpoint of persistancy/liquidity considerations. Do you emphasize GA's? Do you sell direct and build customer relationships? Do you use GIC brokers? What about pension consultants?

Obviously all these affect your product and sales mix. But wait, what about investment opportunities? Can your investment personnel generate investments which are particularly suited to one type of business versus another? If so, do you have the appropriate distribution mix to exploit a possible competitive advantage?

It's easy to belabor this issue but marketing strategy and capabilities and investment strategy and capabilities are tightly intertwined. It's an exciting and interesting challenge to raise the mutual awareness of your investment and market people. When things start to click and it begins to happen, you have a very exciting environment with all sorts of possibilities for competitive muscle. And let's not lose sight of the ultimate goal of all our organizations - to provide products and services to match customer needs!

Let's look at pricing for a moment - a brief moment. The main point I would like to leave with you is that I view this as another area where investment, marketing, product and actuarial personnel must work closely - continually.

If you have the appropriate structure and management attitudes, the smaller company can be very effective and competitive in its pricing. I believe in what you might call marginal pricing where quotes on GIC's can be set in relation to specific investment opportunities and vice versa. Some call this a "rate desk" approach, others might term it "opportunity" pricing. Whatever the term applied, the small company has a real opportunity for flexibility and customer responsiveness through its pricing mechanism.

Now that we have established our product portfolio and have actually sold some business, what do we do with the cash? That's what much of this week's meeting is about. One of the things that distinguishes new investment-based products from more traditional products is that the business must be managed carefully after it has been sold. GIC management is possibly more akin to bank management than it may be to insurance management. For one thing, margins are quite thin and must be monitored continuously. The primary risk in this business is interest rate risk and your investment strategies must be designed to minimize its impact. Fortunately, this can be done through duration-oriented techniques such as immunization, cash flow matching and the like. There is a great deal of literature on these topics and I won't bore you with a detailed discussion of them. What I would note, however, is that the investment process has assumed an additional dimension that until a few years ago was not practiced as nearly as widely as it is today. Portfolio management oriented towards definition and control of interest rate risk has emerged as an important ingredient in the investment process. I am in no way diminishing the importance of the more traditional lending skills of credit analysis, private placement structuring and so forth. It's just that the process has been extended. The investment personnel must understand the mathematics of duration and immunization because that analysis controls investment selection. And believe me the array of choices has become mind-boggling. We have cats and tigers, OID's, puttable bonds, extendables, floating rate preferred, futures, options - the list could go on and on. I believe this also is why my remarks to my new FSA were appropriate. For what the portfolio/investment manager must do today is to structure portfolios in a context of optimization. He, or she, wants to maximize return or interest margin subject to a series of constraints such as cash flow pattern, liquidity, credit quality, tax considerations, duration, etc..

Over the past few years this job has become at the same time more tractable and more complex. High inflation, volatile financial markets, heightened risk conditions have altered profoundly patterns of corporate financing and investor requirements resulting in the creation of new instruments from the investment community and products from the financial intermediaries. In the process the financing requirements of issuers and the savings/investment needs of consumers have been integrated. This process has been and will continue to be the challenge for the investment function in these new markets. More sophisticated techniques and skills are involved and actuaries are an important element in the new investment process.

The investment area also must sharpen its skills. Not only must credit quality be kept as high as possible, but also the opportunities to improve returns through on-going portfolio management must be sought out and exploited. Buy and hold doesn't do the job. Portfolios must be rebalanced relative to duration requirements. Futures and options positions can be shifted to enhance returns as well as to control risk. Value shifts manifested in changing yield relationships also provide return enhancement possibilities which should be exploited. Also, since these new products are "interest sensitive", demand conditions will be affected by interest rate levels and expectations. The investment officer obviously provides important input to marketing strategy and can help the sales effort by correctly anticipating interest rates and acquiring the most appropriate instruments relative to anticipated sales demand.

One final point on the investment process. Management must be total return oriented. Obviously many of us are restricted in our ability realize losses and we must be concerned with year-to-year statutory and GAAP results. These may represent constraints on our ability to maximize total portfolio returns. However, our analytical and decision processes must include total return measures and we must understand the impact of our operating constraints on accumulation of investment results. This is a part of analyzing and managing risks and this should affect product design and pricing.

Investment-based products such as GIC's are asset builders, and as assets grow, surplus/capital relationships become considerations. At least two aspects are noteworthy - valuation requirements and what I would term capital adequacy. From a management point of view the former could be viewed as a cost of doing business, particularly if reinsurance is employed for any required reserve strengthening. Also, those of you who are familiar with New York State's valuation rules know that your investment portfolio structure and its cash flow patterns is a primary determinant of the surplus requirements for valuation purposes. Circular 33 is an excellent mechanism for focusing attention on portfolio structure, interest rate risk management and, more broadly, asset/liability management. It is a great example of where actuaries and investment personnel combine their talents in something that is of ongoing managerial value and importance.

What about the second issue which, drawing on my banking background, I would like to term capital adequacy. Well, in the three or so minutes left, I'm obviously not going to do much with this. But I would like to note that asset and liability mixes are not homogeneous. Obviously if the liability side of the balance sheet is loaded with 3-year GIC's and you have 25-year term bonds as your assets, the risk profile and attendant capital requirements will be much different than a situation where assets and liabilities are in close balance. What would you say about a company where the assets consist of zero coupon AA rated bonds of 3-year maturities and liabilities of 3-year compound bullet GIC's? A great trick if you can do it. The important point is that relative asset/liability structures (the term asset/liability management comes to mind) should have a great deal to do with capital/surplus requirements. Investment strategy, in particular, is a very important consideration where notions of duration, maturity, coupon, cash flow, and credit quality are not arcane matters addressed only by those investment types. I think investment products will have important growth implications for smaller companies and, with this growth, capital/surplus considerations will appear. Investment strategy should be a major variable, particularly with the risk control mechanisms that currently exist and which will certainly appear in the future. Anybody who has watched the growth of futures and options and their applications knows what I am talking about.

A final comment has to do with administration and systems. Two words say it all - cash flows. If nothing else comes through here, I want to stress two things: one - you must know your assets and liability cash flows or have reasonable expectations about them; two - different products have different cash flow patterns and you must identify and manage asset portfolios relative to these products. This is true even with GIC's. I read constantly that our evolving financial services businesses and products couldn't have happened without computers and EDP technology. These products require it and you need it to manage your risks. I would submit that your statutory accounting/reporting systems are not adequate to the task of managing these businesses. Asset/liability management strategies require information of a different nature and on a more timely basis. Those of you who have completed a Circular Letter 33 filing know what I mean.

Let me give you another observation - Line 4 - Page 5 - net investment income is not the appropriate statistic for these businesses. No expense should be a given as "investment expenses" are in this method of reporting. I would submit that you should look first at gross interest margin relative to your targets and then look at expenses separately as manageable variables. Management of interest margins and operating expenses obviously requires different procedures and your reporting should reflect this.

I would like to close with my final point - organization. Active involvement with investment products, such as GIC's, raise obvious organizational issues. Success in this business requires almost day-to-day interaction between various disciplines - investments, actuarial, accounting, systems, and operations - just to list the most obvious. Look at it from the investment point of view - the answer to that question I raised in 1979 can only come from the integrated input of all these areas of your company. And this often is on a daily basis, particularly for investment, marketing and actuarial personnel. Does your company have the managerial structure and process to engage in effective ongoing matrix management like this? I think this is where small may be best. Smaller companies probably don't have the hierarchial impediments to the innovative and nimble management required with these businesses. If we can do this well and cost effectively, these new markets and products offer great opportunities for entrepreneurial rewards. I think the smaller company may be best able to capture and retain market share in these new businesses. Investment management and all that it appears to imply is critical and that's my message.

MR. EDWARD J. COSTELLO: Good afternoon. My name is Ned Costello and I'd like to thank the Society for giving me the opportunity to speak to you today. My background is marketing. And I certainly hope you won't hold that against me.

I am going to address three areas today. First, a definition of growth and a discussion of the strategies that can be employed to achieve it. Second, a reflection of trends in the insurance business. And third, a discussion of the products that are selling, why they are selling, and how you can get into the act.

Let's start with a definition.

Webster's Dictionary defines growth as "a stage in the process of progressive development", or alternatively, "evolution". What does this mean for those of us who are charged with making our companies "grow"? I think there are at least 4 implications.

First, growth is a process. It is a continual set of actions, both planned and accidental, that produce results, anticipated and unanticipated. It is not, in the pure sense an end, but rather, a means. The key is to have a bias toward action -- as Bear Bryant said, "make something happen."

Second, that growth can be managed, controlled and directed. It is, to recall Mr. Webster, "progressive". That is to say it moves forward, not backward. It is innovative, and evolutionary. Biology teaches us that the strongest, most adaptable survive and grow; the weak decline.

There is, however, good news. The odds are on your side. The National Science Foundation, as quoted in Inc. Magazine, found that small firms produce 4 times as many innovations per research and development dollar spent as medium size firms, and 24 times as many innovations as large firms. The critical factor here is creating an environment that encourages experimentation, and importantly, encourages mistakes.

The third implication is that growth moves in stages that are, if not entirely discreet, at least are definable in time and has results which can be measured. Constant evaluation is necessary. The key is to get in early, measure your results, and modify your strategy, if necessary, to fit those results.

Fourth, while growth is clearly a function of both internal (i.e., events that occur inside your company), and external events (i.e., market conditions, customer reactions), external events are more important. The most successful companies have always maintained an inside out perspective. That is to say they focus their energies more on understanding and adapting to the outside world. You must, if you are to grow, develop a good fact base -- an accurate, predictive and quantitative picture of your customers, your market and your competitors. But that is only the first step.

Let's now look briefly at some specific growth strategies.

It is important, before you apply these models, that each of you understand your own company's strengths and weaknesses. It is only at that point that you can extrapolate your best strategy. However, there may not be one strategy at work in all segments of your business or any one time.

In any case, let's borrow the four general growth models from the manufacturing business and incidentally from Mr. Robert Cymbala's excellent writing in Best's Review.

OPTION 1: A broad line national company. Defined here as a firm that operates in all 50 states, that offers a multi-disciplinary product line and that operates across widely differentiated markets. Companies which pursue this strategy are betting heavily on the customers desire to buy via a mode which has been characterized as "one-stop shopping". Typically, their prices are competitive, but not necessarily the cheapest. It is high-value added approach and typically targets the more sophisticated, affluent customer.

What characteristics are needed? First a corporate culture that encourages risks and experimentation; a highly sophisticated technology base to process and administer a number of different kinds of products and still know what the bottom line is; and experience and comfort with several different (and perhaps competing) distribution systems.

OPTION 2: The Product Specialist. The mirror image of the broad line firm, the product specialist has a specific target product line. It is a sort of product niche strategy. These companies build their franchise on selected innovation and quality, and know, in intimate detail, the specific markets and customers for each of their products. Typically, the products are bundled (universal life is a classic example), have a heavy service component and are price inelastic.

OPTION 3: The Market Segmentation Specialist. Similar to the Product Specialist, this strategy focuses on specific areas, but does so by geography, demographic groups, occupations or other specific targets rather than by product.

What is needed to pursue this growth option? A loyal, repeat buying, customer base, a strong market awareness, and an efficient, productive and controllable distribution system.

Options 2 and 3 are hybrid forms of the "boutique strategy".

Finally, OPTION 4: The Low Cost Producer. The low cost producer goes after price-sensitive commodity markets (group products and term insurance, for example), sells hard on the basis of the price advantage, and the entrants are typically new or smaller companies which are not burdened with a present book of business or other cultural or organizational constraints. The successful low cost producers have lean staffs, are sticklers on expenses, have extremely efficient distribution systems and have a productive, results-oriented culture.

The point here is that there are a number of ways to skin the cat. The strategy employed must be an outgrowth of your company's strengths. No one strategy guarantees success, and each carry risks.

Now, let's talk about the second topic, trends in the insurance business and what they mean to you.

Mr. Walter Wriston was quoted recently as saying, "The money stays the same, it's the pockets that change." Indeed twenty years ago life was simple. Inflation was low, 2-3% a year; the economy was stable; there was no international competition; the dollar was the world currency, English the world language.

The consumer was conservative; liked to do business in a highly personalized way, often through friends or family; to paraphrase Mr. Wriston, the pockets were few, the choices simple.

There was a spending pocket, a savings pocket, an insurance pocket and if anything was left, an investment pocket.

Now, inflation has become a problem that everyone from the mailroom to the boardroom talks about; the stock and bond markets have become increasingly volatile and will likely stay that way. The lines of business demarcation that once separated us have become blurred. In short, there are more pockets, and everybody has their hands in everybody else's pockets.

My friends, your business has changed dramatically and fundamentally.

In some states, banks now offer insurance, soon they will have this ability in all states; stock brokers and mutual fund companies now sell insurance; the Federal Government and its agencies are looking ever more carefully at insurance, and frankly, coming closer than ever to regulating it.
The number of agents is declining and the cost of keeping them is increasing, the amount of insurance sold by direct mail is growing rapidly ($5.19 billion in 1982 alone), regulators are requiring more consumer-oriented disclosure, the Supreme Court is telling us that there really are no differences between men and women. Margins are under severe pressure as more and more products are introduced that give market interest rates. We've got single premium, flexible premium, vanishing premium, and level benefit, increasing benefit. We've got fixed, variable, guaranteed, market indices, and a whole host of other somewhat confusing arrays of product benefits.

What we are doing is reacting to a complex world in kind -- by developing increasingly complicated products. I'm not sure that we all couldn't do with a little kiss -- that is -- keep it simple.

In my opinion, many of the products now being developed are over-engineered. They solve problems that customers either didn't know they had or didn't consider a problem. Frankly, I would place many of the current Universal Life products in this category.

But the general trend, of which the preceeding items are only symptoms, is a movement toward organizational change that is consumer-oriented and product-driven.

What does this mean?

As you enter new markets, develop new products and adapt to new changes you will be competing not only with the people sitting next to you in this room, but also with banks, securities firms, and mutual fund companies, all of which have service and cost characteristics that are different (i.e., typically cheaper) from your own. In order to compete, significant structural changes will be needed.

The key to this change is marketing focused -- and it demands that customer needs drive the product benefits, and further that product needs drive the organizational structure and systems so as to provide fast, efficient, cheap customer service.

You cannot simply develop me-too, undifferentiated products, attach them at the end of the product portfolio, and expect to be successful. In other words, what has to change is the way these products flow through and out of the company. Change is needed in at least four specific areas.

First, you must recognize that the customer is king. Service to customers is perhaps the most significant structural change. Customers are mobile, huge blocks of money can now move with a single phone call. Responsiveness as an organization to product, market and service needs is vital. The non-traditional products require heavy service -- in fact they encourage it. High volume, low margin products have different requirements than low volume, high margin, high value products. Yet, all products are typically processed in the same way from an organizational view.

The second area is in the use of computers. Most functions can be more automated. Transactions processed by machine are cheaper, faster and much more flexible. Further, the newer products are bigger users of computers and of systems resources. Could anyone here even envision Universal Life without computers? I think not. So you need to focus on work flows, with an eye toward letting the product determine the structure of the system, not the reverse.

Third, asset/liability management has become the watchword of the 1980's. This is an outgrowth of high and volatile interest rates, shorter product life cycles, and customer mobility. The investment function and the insurance function must operate in tandem - interdependently rather than independently, which characterized these functions in the past.

Fourth, customers increasingly desire to manage their own insurance portfolios. Witness the growth of variable life, variable annuities, market value adjusted products, etc. You must develop competence in a new business -- the world of equity based instruments as products in and of themselves, whose performance is not buried in the overall results of the general account, but rather whose results are published, promoted and easily compared. Good equity management means good performance and all other things held constant -- good performance means higher sales. It may well be that, at least in the short run, it is cheaper for many small companies to look at an outside manager who has got the all requisite expertise.

What you face here is the classic buy or build decision, and its not easy. Let's move now to the third discussion point -- products.

What is hot? Well, in 3 words, non-traditional policies. Confining myself to the life insurance business, the biggest new sellers have been Universal Life and Variable Life. Let's first begin with Universal Life.

It is pretty clear that Universal Life, if that term can be used generically, has been the big winner. The number of companies offering UL products has gone from 1 in 1976 to at least 200 today. The market share of sales for Universal Life has doubled in each of the last 3 years to 18% in 1983, or $1.36 billion in premium and many observers expect UL sales to represent as much as 25-30% ($1.8-$2.5 billion) of life sales this year. That means, at the high end, each share point is worth $25 million.

Many companies, both large and small, report that Universal Life represents 50-75% of their life sales.

The average buyer is professional, purchased nearly $100,000 of face amount and paid over $1,000 in premium.

This trend may flatten, but it will not disappear. Why this phenomenal growth? I believe there are 3 reasons.

First, UL is very firmly rooted in the traditional policy mode. It has the same tax benefits, the same protection features and essentially the same structure. But, it is more flexible and it gives the customer control over how to use the product. Further, nearly all necessary management skills are already in place. In marketing parlance it is line extension.

Second, it carries guarantees at or near-market interest rate and, therefore, allows faster asset accumulation and makes replacement exceptionally easy. People are very attuned to interest rates and the fact that UL gives them everything their old policy has (or for the first time buyer, everything they think it should have), plus a market rate. This makes it a highly saleable product.

Third, it can be sold by anyone who now has a life insurance license. So there are no further regulatory hurdles, and no additional licenses required.

Universal Life is itself a stage. It is not a panacea and, as those of you who now write it know, the investment risks (primarily interest rate and disintermediation risk) are higher, the profit margins lower. And perhaps most important, since the products are so new, the information gap is wide.

As time goes by and companies move up the experience curve, these products will become more competitive, less complicated and perhaps less expensive.

One word of advice. Despite the fact that Universal Life is a general account product, my sense is that it is different enough from the rest of your current product line to warrant both separate asset accounting and bookkeeping -- in effect, a separate account within the general account.

The sleeping giant is variable life insurance. It is as you know, a hybrid product that combines an investment component with an insurance component. In 1983, estimates claim that variable life captured a 2% market share of sales. However, its share has also doubled in each of the last 3 years and industry watchers expect a 7% share in 1984.

Why so low?

In my opinion the very reasons that made Universal Life successful have, to date, curtailed the sales success of variable life.

First, it is untraditional in most senses of that word. Variable life provides minimum guarantees on the death benefit, no guarantees on the cash value. The customers value in effect fluctuates daily. UL gives control to the customer, variable life gives control to the market.

Second, it is a whole new business and few insurance companies have in house all the skills and expertise necessary to build and sell the product. It requires lawyers familiar with securities law, systems that can calculate values daily, and lastly, experience in managing separate accounts using equity funds whose performance can not be buried. Replacement is made more difficult, and the current products are very complicated.

Third, the sale of variable life requires essentially the same licenses as a securities broker -- and not all agents will take the time out to pass. But

I still believe, despite these constraints, that variable life will, in time, surpass Universal Life. Experience in Europe bears this out.

The key, again, is performance. The insurance components are easily understood internally. The development, registration and introduction of a mutual fund -- which is the essential funding component of variable life -- is not as easily understood. And if speed is important, then I would suggest you at least investigate using an outside manager with a proven track record.

As a summary, I'd like to leave you with the following thoughts.

1. The insurance business is changing rapidly. There are new products, new competitors and new demands for quality and service being made by customers. To compete successfully, an interdependent, fully coordinated strategy encompassing all functions must be carefully developed and thoughtfully implemented. Fundamental organizational change is necessary.

2. The product life cycle is significantly shorter today. Consequently, you must push products out faster, evaluate their results faster, modify the design if necessary, then move on to the next new product. We can never rest on last years laurels.

3. Customers are more interest-rate sensitive and more value conscious. There will be continued pressure on margins and profits. However, these customers are also, if packaged properly, quite willing to assume more of that interest rate and investment risk.

MR. EDWARD J. SLABY: My experience in the last ten years has been as an Actuary with smaller life insurance companies. For about one year I have been serving as the Chief Financial Officer of our Company. We are a smaller New York mutual with assets of about $200 million. I don't need to tell you that there has been a lot of activity by smaller companies in investment oriented products. Let's review some of the history of such products.

In 1974, IRA's were created by the passage of ERISA, and led to general introduction of flexible premium retirement annuities by life insurers, including smaller companies, wishing to serve this market. At first companies viewed FPRA's as simply a flexible premium version of the traditional retirement annuity and invested accordingly. The yield curve indicated long bonds for yield and little attention was paid to the interest sensitivity aspects or asset duration.

FPRA's then began to be used to fund the side-fund under individual policy pension trust cases, and finally became the only product for smaller pension clients, tax-sheltered annuities and other qualified plans. The late 1970's also saw the FPRA being used in blended-premium products, where a traditional term or graded premium whole life plan would be attached to a deferred annuity policy or rider with the resulting meld allowing the policyholder many of the attributes of universal life including a great degree of premium flexibility.

During this same period several smaller companies began to market Universal Life, which has since become the dominant product for many companies.

My own perception of this period is that, unlike John's company, most smaller companies did not consciously decide on a strategy of emphasizing asset-building products, but the marketplace and the needs of their field force made the decision for them.

As the evolution from traditional fixed guarantee contracts to the new generation of high-performance products took place, there were concommitant changes to the economic environment. The oil embargo of 1974 introduced us to high inflation and consequent run-up of interest rates. The introduction of money-market funds and the subsequent deregulation of the banking and savings and loan industry introduced very competitive financial investment products to the retail market. Inflation gathered momentum until in 1979 the Fed bit the bullet and an environment was created where there were not only high rates but a very volatile securities market, where bond prices would move more in one day than they had previously moved in one month. This was the era of the inverted yield curve and if you weren't in excess-interest products by then you found it very tempting. Just bring in investable funds and enjoy yields in the high-teens with no liquidity problem.

In adapting to these external forces, smaller companies had to develop high-performance insurance products to maintain positive cash flows. To remain successful they have also had to adjust their operating structures.
My own company has enjoyed a rapid 20% rate of growth in assets over the last five years. Most of this has been generated by FPRA products. We have been very successful in building up our tax-sheltered annuity business. We do not sell SPDA's; approximately 90% of our annuity business is sold in conjunction with some type of qualified retirement plan. Our annuity business has been a relatively stable line which has not exhibited volatility in response to changes in the interest environment. Our major product outside of the tax-qualified area is a blend of a graded premium whole life policy with an FPRA rider for cash value accumulation. Like other smaller size companies, the pressure of managing a high influx of investable cash has caused us to evolve new ways of managing our business.

I'd like to talk about those which related to today's topic. Organizationally we have coordinated the functions of the Actuary, Controller, Treasurer and Reinsurer by having these departments report to the Chief Financial Officer.

We have placed emphasis on a modernized Treasury function. This is seen to be a key operating position in the attainment of Company goals and guarantees. In addition to active and aggressive cash flow management, our Treasurer is also responsible for coordinating the investment activities of the Company. We use an outside investment advisory firm as our "investment department", and they have a lot of discretion in the execution of our investment policy. It is the Treasurer's responsibility to communicate our investment policy to them and that means he needs access to the product and cash flow information to formulate quantified statements of policy. In order to handle the new information systems, we have placed a Systems Analyst in the Financial area as a dedicated resource in order to give that area greater control over the development of its own MIS requirements.

John has given a good overview of the conceptual and analytical tools required to rationally manage interest-sensitive business. This requirement can be a major hurdle for a smaller company. Although the theoretical basis for asset/liability management has evolved to a pretty high state-of-the-art, the typically limited resources of a smaller company make the development of new systems tailored to the product and administrative environment of the company a difficult undertaking. But is has to be done. We have adopted a practical approach that you might call the "good-enough" approach. We simply don't have the time or resources to over-engineer our decision support systems to an ideal state. If the economic world ever slows down for us, then we will worry about refinements. For several years our Company has used an internal, notional segregation of assets to manage the flex annuity cash. This was run in conjunction with an Investment Generation Method used to allocate investment income by line of business in external financial reports and for dividend management. From the start there were difficulties in coordinating the results of the two decision support systems. We are now implementing a simplified segmentation system which will replace both methods and guarantee consistency in all of our financial reporting and decision making.

Our internal financial reporting is shifting to a product-line focus for responsibility reporting and we have made a substantial investment in the development of forecasting systems to enhance control of our insurance operations. A useful by-product of these systems is the availability of insurance cash flow predictions for various marketing scenarios. We are using the asset data base developed for our segmentation systems to prepare cash flow forecasts for investment operations. We expect to do a better job of matching asset/liability durations under various scenarios tested in these systems. As we improve our ability to anticipate cash flow we will be able to make our money work a little harder.

We are fortunate in having a high caliber Finance Committee as part of our Board of Directors, which is responsible for overseeing investment policy. Just as the Company has had a learning curve to climb in learning to manage new product lines, we have had to keep the members of this Committee informed with respect to product-driven investment strategy. I have found that the more they know about our investment requirements, the better the input we receive.

Specifically, unless they are involved in their own businesses with asset/liability management, they are unlikely to understand the constraints on investment policy which arise from trying to properly manage an insurance company's balance sheet.

On the other hand, the accumulated business experience of this Committee is of great help in sorting out risk/reward considerations and in judging the performance of our investment managers.

Their contacts and awareness of opportunities are a source of out-reach for direct placements which is an area that small companies usually overlook because of resource limitations.

So far the issues and tactics I have discussed are not unique to smaller companies. My main message is that the smaller companies are under pressure to bring their asset management techniques up to the same level of sophistication as the larger companies and that the forces impacting on them are changing the way they look at themselves and how they are organized to get the job done. There are several issues which, while not confined to smaller companies, will have a greater impact on their methods of operation than in a larger organization.

In order to absorb the surplus strain from writing large quantities of annuity business, small companies may resort to surplus relief reinsurance. In general these treaties are written as a mixture of coinsurance and modified coinsurance, with a reinsurance allowance paid to the ceding company which is equal to the coinsurance reserve ceded. Unless withdrawal experience is far worse than expected there should be little cash flow other than the risk premium paid by the ceding company. Recapture is usually phased-in over an 8 to 10 year period, depending on experience.

These types of treaties do not transfer investment risk and will not reduce liquidity concerns. Information systems to monitor investment requirements must work off of the direct numbers for the annuity contracts. Also, the inexorable recapture schedule dictates that no conceptual allowance be made for the coinsurance reserves transferred.

It is assumed that smaller companies have an advantage in this area of new, investment-oriented products since there is an opportunity to make new sales from the replacement of old business written originally by other companies. This is true of newer companies, but there are many smaller companies who have older blocks of business which are vulnerable. In order to conserve these policies, smaller companies must look to update programs and internal replacement.

Such programs cause investment complications. Premium income is likely to decrease and to become less predictable as will the cash flow from the segment being replaced. A more difficult problem is the performance of the underlying assets which are presumed to continue to support these policies after internal replacement. Older blocks of business tend to have older investments with term and yield characteristics which are totally inappropriate as supporting assets for new-wave products. A partial solution is to have in place a segmentation of assets which identifies the "corporate" component of surplus and to trade assets with corporate surplus in order to enhance the asset mix supporting the new policies. Practically, you will have a major new element to consider in setting investment policy and it may take years before the assets of this block can be optimized.

From a smaller company's viewpoint, while the new interest-sensitive products provide the opportunity for a fast rate of growth, there are new techniques which must be mastered in order to handle the build-up of assets which need to be managed for high performance without the cushion of redundant actuarial margins that was present in traditional products.

There are organizational implications, including revamping the financial function, use of a fast moving ad hoc organization alluded to as a matrix organization for product development, internal product line set up for financial reporting, and judicious use of outside services for sophisticated investing.

MR. LADLEY: We'll now entertain questions from the audience.

MR. GARY FRISCH: Mr. Slaby, I wonder if you could go over some of the general ways that a company might approach the surplus relief treaties, their cost, and the features that are common.

MR. SLABY: Well, as I said, we're using treaties which we renegotiate each year, which depending on our marketing plans, involve a mixture of coinsurance and modified coinsurance. These are especially useful in picking up things like "deficiency reserves" that come about because of interest guarantees. Cost for such reinsurance is a market price that you have to negotiate and it's a function of your company's relationship with the reinsurer, interest conditions at the time, and I've seen the cost run from 2 1/2% to 4% of the coinsured reserves. I heard at lunch today that Manhattan is able to cover some of its so-called deficiency reserves at a cost that amounts to about 10 basis points off their yield. I think that compares with what we have found. The mechanics are available at your neighborhood reinsurer.

MR. ROBERT NIX: Mr. Slaby, how are you handling you interest credits on your flexible premium annuity money? Are you giving it current yields or portfolio rates?

MR. SLABY: We have two strata of money, new money and old money, and they get different yields. These tend to have a one year guarantee which aligns with the dividend year, but it's not coincident with it. Actually, it's an allowance for one year, but it is a guarantee. We are able to adjust that in response to market conditions, but have found that it's not a useful marketing tool.

MR. NIX: Do you keep track of each years' deposits using an investment year approach?

MR. SLABY: Yes, we have been keeping track of our assets on a segregated basis by generation of assets and monitoring the rollover of these investments, and the reinvestment of the money from these investments. We're now switching to a segmented basis, but it's going to be the same style of keeping track of it by layer, by period of when it came in.

MR. JACK TAYLOR: I can see the advantages of the small companies and their agility in being able to react to the marketplace opportunities, but with the new products that are currently in the marketplace and the complexities of fund accounting and computer administration systems, it seems to me to be raising issues of cost which may be beyond the small company. Ed, how do you see the small companies reacting to those costs?

MR. SLABY: I'm still struggling with our insurance expenses and how to spread those properly, but I think that we're hoping that there will be some vendors providing services that we can buy and spread among other small companies. If we all have to invent our own systems, it's going to be very costly and I don't think we'll be able to survive on that basis.

MR. COSTELLO: I'd like to make a brief comment. One of the benefits of some of the newer products seems to be that they are directly passing through a lot of the cost of administration. There are charges for issuance and I think that's really an attempt to wrestle and solve the problem and the issues that you've just raised.

MR. TAYLOR: One other issue on that note, the only trouble is here, with the new systems, you see the costs. They are very competitive, and when you start to talk about seven-figured numbers for administrative packages, it's very difficult for a small company to spread that.

MR. COSTELLO: That's a question of how much business you write, because it translates into basis points on the business. I think the issue is that you need more efficient distribution systems to get the volume needed to get the basis points down.

MR. SLABY: I will say that that is a very tough problem and we're working on a lot of financial options such as mergers and demutualization. It will be interesting to see how this works out for our company.

MR. CHRISTOPHER WAIN: Mr. Costello, suppose a small company wanted to use more of variable life business and decided the best way was to do it with an established mutual fund.

MR. COSTELLO: There's a number of things that you would have to face. Laying out the problem the way you have essentially covers the worst hurdles. You've decided that you want to be in the business and you want somebody else to manage the money. That's probably 70% of the battle. From there, assuming you could find somebody to set up and manage the funds for you and agree on what the price of those services was worth, then it would be a question of putting together a filing package with the Securities Exchange Commission, which isn't a particularly difficult task, but takes 3 or 4 months. Now you would have to tie in the mutual fund segment of the product with the insurance aspects. And to go back to a question that was raised earlier, there are a number of people that are already doing the processing work which makes it easier. Because if the insurance company is keeping the insurance records and the mutual fund company or investment manager is keeping its records, you need to have those systems and operations talk to each other and that's not the easiest thing in the world to do. For that very reason we have sought to use third party administrators to do the contract owner recordkeeping. It's much easier to have the two partners, the insurance company and the investment manager, talking to the third party administrator who can then give them the needed pieces of information on a timely basis.

MR. MICHAEL PALACE: Obviously, a small company who has to compete in the New York brokerage market can't keep on selling the good old vanilla whole life. They have to move into something with a little more modernity in it. For Universal Life and Variable Life products there seems to be a tremendous investment that has to be made in systems, hiring investment managers, bankers, lawyers, etc. in order to be ready to sell the first policy. On the other hand, direct response is another avenue that a small company might embark upon. I need some suggestions for a small company seeking to move forward. How would you weigh the relative merits of direct response, where you don't have to worry about agents and agencies and each one constantly replacing its own business, with respect to this Universal Life-Variable Life approach?

MR. COSTELLO: I think that the question of your distribution system and what you do with it looking forward has got to be centered around how well it's working for you now. If it's working okay, then you're going to have to be very careful giving that new product to somebody else or to some other distribution system. If the distribution system you have now is ineffective and you've considered getting rid of it, then I think that brings up an entirely different set of questions. But don't be misled. To start from scratch a direct response distribution system requires everybody and their brother getting into the act and a lot of up front expenses. And most of the money, unlike agents who get paid on what they produce, is due on or before day 1. You've got to set up the Watts lines, buy the list, train people to answer the phones. It's not a simple thing. What you might consider is looking for ventures with people who already have some marketing expertise and their own customer list and offer to manufacture an appropriate product for them (without your agents finding out about it ahead of time.) That might be one hybrid solution to test whether the use of direct response is a fit for your company longer term.

MR. LADLEY: If I might comment on two things that Ned alluded to. First, a major determinant is going to be the political structure of your company. Companies dealing heavily with independent agents, debit agents, industrial and captive agents are going to find it extremely difficult to deal with the controversy generated by direct response and that is often the major issue that has to be dealt with. It therefore becomes a momentum decision to move with Universal or Variable Life or a combination of the two, to work with the agency system.

Second, I want to ask the age old question of Ned as to whether investment-dependent products can be sold through direct response methods.

MR. COSTELLO: I quoted a LIMRA statistic that said $5.2 billion of premium were raised using direct response methods and it will probably be bigger next year. At Fidelity we manage money and run mutual funds. All of our business is generated using direct marketing/mail techniques. It has worked very successfully for that business. Of all the people that call up and ask for information on our products 30% of them end up being accounts. You should challenge your sales force to do that good. So if it's structured properly, it can be done. In terms of the insurance products, we've stuck to the simple ones and have been successful. We will raise $250-$300 million of premiums this year using direct mail for annuity products. Yes, they can be sold using direct mail. As long as the products are structured properly and simply designed so that they can be 95 or 100% understood by the customer without direct intervention by an agent. You must also have a well-trained telephone staff. Financial products of any sort can and will be sold in increasing numbers using direct mail.

MR. JACK Mc CLELLAND: I'm from Continental American Life, a stock company that about 10 years ago began moving from an agency distribution system to direct response. I just wanted to echo some of the things that Jack Ladley and Mr. Costello have told us. It is a different business, involves a different culture, and requires different talents to be successful. It requires a different way of looking at administration and marketing. It has its own products, their needs and design. It has its own risks, rewards and substantial problems as does any business. There are opportunities for companies to network or joint venture their interest in this business, but I would echo that fundamentally it is a different business with a different culture and your organization has to be prepared for the changes that will flow from it.

MR. COSTELLO: You are absolutely right. As you alluded to, one interim step could be to form some kind of a venture with a company that already does direct marketing and has its own customer base to act like a private label manufacturer. Get to know the company you are working with, and how their business works. Most of the people are willing to show you how it works because they're proud that it seems to be working.

MR. SLABY: I'd like to share some of the things we're doing at Unity this year. I mentioned the 20% growth rate for 5 years. This tends to strain the surplus so we're demarketing a little this year and have a little hiatus with which to experiment. We're reaching out to major retailers in our local area - supermarkets, drug store chains, banks - to see if we can put together joint marketing ventures where we would supply the insurance product. We've had a lot of interest. We're working with a major supermarket and this summer will place some agents in what they call power alley, the first right turn as you come in the door. They'll have other financial services there. We've had to entertain some new pricing variables, like revenue per square foot, in our calculations.

Also, we are entering into a direct marketing experiment. This will involve kiosks and booths in malls in our local area. During the experimental phase they will be staffed entirely by home office employees. The officers feel that we'll at least get the humbling experience of trying to sell insurance. It should also be noted that senior management has drawn the weekend shift.

MR. JOE KOLODNEY: I'd just like a comment from the panel on a possible distribution problem these small companies, brokerage or GA companies, have when you get into registered products. It's my understanding that an agent can only be registered with one broker/dealer. And if you're in the brokerage business, you're attracting production from people who may be licensed with other companies. I would think that there's a fairly complex hurdle to cross to attract that production source with sufficient product, compensation, or something else in order to forego a broker/dealer he is already registered with, especially if he happens to be in a career agency company. I'm wondering if Mr. Slaby has any thoughts on that, because I think you rely on noncaptive sources of production.

MR. SLABY: We're looking at purchasing some agents that themselves own broker/dealerships and form a miniature captive agency system. But that's about as far as we've gone.

MR. COSTELLO: I think there are two choices: one is to form a broker/dealer, the other might be to form some sort of a joint entity with somebody who already has it.

MR. ACHENBACH: We're a general agent company as well and we do not sell any registered products at the moment. Our conclusion at this point is that it really is a major hurdle to overcome. We have general agents that I think are interested in registered-type products, some of which are NASD registered. I don't think the proportion is very high but this is a very significant issue. You have to start looking at other distribution channels outside of the traditional GA network, which is a very effective form of distribution today. We are doing some work with broker/dealers for single premium deferred annuity products, trying to be very careful and controlled on how we do that for obvious reasons. That may be a possible channel for registered-type products which would fit reasonably well with a GA-type environment.

UNIDENTIFIED SPEAKER: Mr. Costello, you were mentioning that you see a good future for variable contracts which I take is variable on the asset side. Right now the market is down maybe 10-15% from its recent highs and even IBM is down maybe 20%. So the problem is deciding when to sell when your money is in equities. And I would hate to have to sell right now. There can be some real problems in a world of people who are used to having guaranteed values.

MR. COSTELLO: I think you're right that there is a problem and it doesn't make it any easier to sell in an environment like this. However, Variable Life is very likely to be a product that is more appropriate for a sophisticated audience. I don't know that you will ever get the kind of penetration that traditional life and universal life will get among the rural, conservative folks. On the other hand, it is true not only of insurance, but for other equity-based investments as well. Most of the people that purchase those to have some sense of these facts and perceive it as a way to basically purchase more for less. Look at the results in Europe where the tax situation is a little different, and beneficial, than it is here. But it's a question of conditioning and of people tending to look more at those things which provide them living benefits as opposed to the benefits that somebody else gets. This is particularly true with some of the recent stories with Social Security. I don't think there's any answer to that, but it may not be a major deterrent. It hasn't been that way with IRA sales backed with equity products, with pension plans, and others that provide the same objective as insurance.

MR. ROBERT NIX: I have one observation which may also be in the form a question to Mr. Costello. From the perspective of a investment/portfolio manager, I see portfolio management techniques that really are just as much risk control oriented as they are maximum return oriented. The development of financial futures and different forms of options reflect this trend and it may well be that the variable products developed have some down side protection. There's a cost associated with every benefit that may limit you on the upside, but nonetheless you still retain the characteristics of a variable type product. Do you see any or have any thinking along those lines at Fidelity at this point?

MR. COSTELLO: You are right that some of that is going to happen. We see people that look not only at the equity funds in general but also look at some sort of stop loss mechanism. I looked at a proposal a couple of days ago to do just that. Some kind of downside immunization strategy when using futures, puts, etc. can provide the floor guarantees. In exchange for that you would like people to indicate that they will leave their money in that vehicle for some period of time. But you can't. You would like five or ten years in which to balance the good years with the bad. Immediate liquidity at 100% cannot be easily found.

UNKNOWN: I think you can discard the word guarantee and substitute the term target.

MR. KOLODNEY: I have a couple of comments relating to Bob's question and some of the answers here. One, my impression that new variable life products are not solely equity based investments. In fact, they have money market fund type investments. Two, my understanding from talking to Equitable is that you might think the market is upscale at the Equitable and to Hancock, particularly the latter, but it's the ex-debit agents at the Hancock that are selling the most variable life. Three, the little people buying there seem to have a very good sense of timing. Equitable noticed a tremendous shift from money market funds to equities in July, 1982 and that seems to be holding. The choice of the little fellow seems to be better than the investment advisors.

A question to John relating to this whole issue that Joe raised. We have a PPGA company and one of the major concerns is this move of the major mutuals with career agencies to lock in their field force with variable products. If they are to retain their same distribution system will they not in fact have to get in that market as fast as the large companies in order to protect their investment and their distribution.

MR. ACHENBACH: We do have some PPGA's in our distribution mix, but I would say we have more of a brokerage oriented environment. There's no doubt that an issue with our field force lies ahead with certain of the more traditional agencies. I guess our theme is that you have to broaden your product mix, you have to be able to operate in different marketplaces. The organizational type of GA may have an edge over the PPGA, unless that PPGA happens to be very effective in specialized marketplaces. Clearly the concept of niche and segmentation becomes relevant. On one hand you have the loyalty of long time agents that can't be discarded lightly but on the other, the competitive conditions of the marketplace are going to control what happens. It's a very tough issue, I don't know what the answer is.

MR. KOLODNEY: I'd like to make just one more comment. Your focus seems to be on equity products or money market, but if you go to Europe, especially the United Kingdom, unit linked life insurance is the nucleus product for what we're now trying to do here. One of the things that really bailed out a lot of the equity problems was the fact they were able to invest in real estate and property funds. That saved a tremendous number of the performance funds over there when they had the inflation and the stock market to contend with. Also there's a more level playing field since last March. The tax rebate for the purchaser of unit linked life insurance got abolished. So now they're going to have to play real games like how do you sell life insurance, even though they will still have the mutual fund approach that the unit linked funds gives them. But Ned, what is your opinion on the use of property funds in Variable Life?

MR. COSTELLO: You're right with respect to your analysis of the British situation. I didn't mean to infer from my comments that there was direct comparability because clearly there is not, for a lot of the reasons you suggest. I think there is a future for using real estate funds to back insurance. There are a number of variable annuity products out there today that use real estate funds or mortgages to some degree. My feeling would be that if the company has the expertise and uses those kinds of funding vehicles blessed by the SEC then there are a lot of consumers that want to get into the less than $100,000 increments in the real estate market. You can tell them that they can now be a sort of big time investor. And there are a variety of pitches that seem to be working. Real estate makes a lot of sense for the individual who has reasonably long term objectives for this fund.

MR. LADLEY: Just a couple of comments relative to your commentary on the UK. A couple of other reasons why that product did well were their tax, inflation-immune types of securities, and somewhat less stringent valuation and regulatory requirements. But as the common market forces its way of doing things more on the UK, some of those companies with their systems and knowhow in this area could easily become major players in variable products here.