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MARKETING OF PENSION PRODUCTS BY A LIFE INSURANCE COMPANY

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Pension funds make up a large and fast growing pool of capital and represent an attractive market for various providers of financial services. This discussion will focus on the strategies and products used by both Canadian and U.S. insurance companies in marketing their products and services to this market.

- o Market segmentation
- o Guaranteed investment contracts (GICs)
- o Single premium group annuities
- o Investment management products
- o Plan services
- o Marketing and distribution

MR. DARYLE G. JOHNSON: The marketing of pension products by a life insurance company is a timely subject which has seen significant change during recent years. During the last 5 to 10 years, new companies have aggressively entered this market, and other companies have made substantial changes in both the products and services they offer in this market as well as in the strategies and methods used to market these products and services.

MR. RICHARD J. BARNEY: My employer, the Prudential Asset Management Company, is a subsidiary of the Prudential Insurance Company of America and not the Prudential Assurance Company of Canada. When I refer to "Prudential," it is to the one founded on the "Rock of the Hackensack Meadows" and not to our Canadian brethren.

Since I have worked primarily on the pricing of guaranteed products, I have had only minimal involvement in marketing. However, the general nature of the financial services industry has been revolutionized by the blurring of traditional marketplace distinctions. We all have had to become aware of the need to assess better our places in the market. Our daily regimen involves strategies for confronting an ever-rising level of competition and demand. So, I would like to summarize some of the characteristics of the institutional asset management business, the current position of the U.S. life insurance industry in this business, and the changes that we at Prudential feel will be necessary to compete in this market. Because of the minor role now played by insurance companies in plan recordkeeping and other actuarial services, my primary focus will be on the pension asset management business.

THE MARKET

Let's begin with an overview of the pension asset market as illustrated in Exhibit A.

U.S. money managers held roughly $1 trillion for tax-exempt clients at the end of 1983. Over 90 percent of these assets were in retirement and savings plans. About 54 percent of retirement plans were corporate sponsored, 8 percent were joint management/union plans, and a significant $288 billion, or about 30 percent, were public employee sponsored. Institutional assets grew at roughly 18 percent annually from 1978 to 1983. We expect these assets to continue to grow at roughly 13 percent per year over the next five years. Since these figures were gathered from a decennial study done by a consulting firm, we have not been able to update these numbers, but I do not believe that the relative percentages have changed significantly.

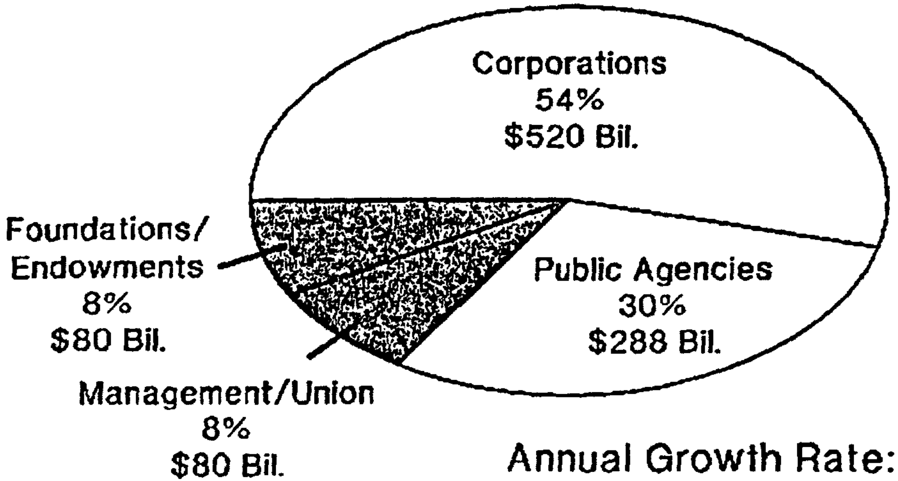
An important recent development in the U.S. market has been the rapid growth of defined contribution plans and a slowing in the growth of defined benefit pension plans. The strong stock market of 1982-84 and high money market rates have combined with long-term conservative actuarial funding assumptions to reduce unfunded pension liabilities, resulting in a great number of plans which are overfunded on a plan termination basis. At the same time, companies unwilling to finance their needs in the current market and strapped for cash have realized that their pension fund may be a source of internal cash generation. Likewise, the onslaught of corporate raiders has focused attention on the millions of dollars of potential profit in overfunded pension plans. As a result, single-sum-annuity closeout business has become a growth industry. It has expanded from a market of about $700 million in 1981 to over $4.1 billion in 1984. While declining interest rates in 1985 may have slowed the sales of closeout business, we at Prudential have seen a 60 percent increase in first quarter sales from a 33 percent increase in proposal activity. Perhaps the spectre of potential tax penalties on asset reversions may be offsetting the disinclination to purchase annuities at current rates.

Most defined contribution plans provide a wide choice to employees in determining plan investment options. Employees are typically conservative. Most of them direct new contributions to guaranteed return investments such as GICs; and relatively small percentages to actively managed equities or bond portfolios.

In the defined contribution market, liberalized tax deferral provisions have stimulated the growth of individual retirement accounts, 401(k) options, profit sharing, and other defined contribution plans. These

INDUSTRY CHARACTERISTICS

Total Institutional Assets - 12/83 - $978 Billion



Annual Growth Rate:

1978-1983	18%
1983-1988	13%

plans transfer the risk of realizing adequate retirement benefits from the sponsor to the employees. The tax advantages of employer-sponsored thrift plans have made such plans a more important feature of employee benefits in the U.S. than in Canada.

These trends have contributed in 1983 and 1984 to an explosive growth in GICs. Over $13.5 billion of 1984 sales were reported by the Life Insurance Marketing and Research Association (LIMRA). This is almost a 50 percent growth over the results for 1983. Additionally, the shortening of GIC maturities has contributed to a substantial growth in "rollover" business.

Given the size and growth rate of pension business, who are the players in this market?

Competition in the pension asset management business is intensive and widespread. It is an easy entry business with more than 300 firms seriously competing and with industry "giants," including Prudential, holding only 3-4 percent market share. Competition varies significantly by product line.

The larger insurance companies dominate the GIC business. Of the $13.5 billion of 1984 sales reported by the LIMRA, 73 percent was sold by six companies. A major market also exists for second-tier companies. Their share of the market has grown tremendously over the past three years. However, even with the advent of the dynamic reserve valuation law for U.S. companies, a significant amount of surplus strain can still develop from a large block of GIC business. At 1985 projected valuation rates, the average reserve strain on this year's GIC business could be as much as 5 percent. Nonetheless, if interest rates remain at or below current levels, the share of the 1985 market available to the second-tier companies would expand dramatically, due to the decreased level of surplus strain incurred.

Until 1981, the U.S. real estate equity management business was also the domain of larger players such as Prudential, Equitable, and First National of Chicago. Prior to 1981, large corporate plans invested primarily in pooled open-end funds. However, since then they have committed increasing amounts to closed-end funds and individual accounts tailored to the investment strategies of their specific plans. Managing these smaller closed-end funds may not require real estate capabilities as extensive as those of Prudential and Equitable. Consequently, 10 to 20 smaller aggressive investment advisory firms have captured a major share of new institutional real estate investments since 1981. Nonetheless, the percentage of pension assets currently invested in real estate still allows for significant growth in this market.

Common stocks and bonds together account for over 75 percent of institutional assets. Banks and trust companies have continued to lose market share in these categories. Banks' market share dropped from 64 percent in 1973 to 43 percent in 1983. Insurance companies had consistently retained about 4-5 percent of the market in the 1973-83 period. The share of stock and bond assets managed by nonbank and noninsurance company advisors increased dramatically from 31 percent in 1973 to 52 percent in 1983.

The success of nonbank/noninsurance company advisors can be attributed to several factors:

1. A commitment to and a specialized focus on stock and bond management;

2. Compensation arrangements which attract and retain qualified professionals;

3. An ability to control growth of assets in line with the professional capabilities to manage these assets effectively.

Smaller advisors, popularly known as "investment boutiques," have received considerable publicity because of the disproportionately large share of new money which they received from plan sponsors during the 1982-83 bull market.

However, with the poor performance of small capitalization stocks in 1983-84, many boutiques have lost their appeal, at least temporarily. Also, to assess properly the relative importance of these smaller advisors, it should be noted that over 90 percent of all assets managed by these advisors are accounted for by firms each of which manages over $2 billion in assets, a size where a firm can hardly be called a boutique. In other words, small size is not necessarily an essential characteristic of the nonbank/noninsurance company advisor.

HOW DOES AN INSURANCE COMPANY COMPETE?

In developing any marketing strategy, the point of departure must always be a critical evaluation of the marketplace and the individual company's strengths and weaknesses. In the April 1, 1985, edition of the Wall Street Journal, Michael Porter gives the seemingly paradoxical advice that one key to successful marketing is to keep your competitors healthy. He stated that it was most often the strength of the competition which defined and circumscribed the market for any given company. For example, one of the most enlightening speeches I have heard in the past several years was made by Jack Kittredge of the Prudential. As an interim report on his long-range planning task force, he outlined the change in the U.S. financial services market. He started with the standard insurance industry competition of the early 1970s which was dominated by the insurance giants, Prudential, Equitable, Traveler's, and the Metropolitan. He illustrated that Prudential's traditional competitors had slipped in comparison with the emerging financial powerhouses of Shearson/American Express, Sears/ Dean Witter/Coldwell Banker, and Merrill Lynch. The market had changed, and Prudential has had to change with it.

An example of the same phenomenon in the U.S. pension field is the emergence of the actuarial consulting community as the major force where the insurance industry had once played a significant role. The result has been a continuing exodus of U.S. insurance companies from the actuarial consulting business. Equitable, Lincoln National, Mutual of New York, New York Life, and even Pacific Mutual have all abandoned the consulting business. Head-to-head competition with the major consulting firms no longer offers the most efficient use of company resources. Even my own company has decided to divest itself of its individual policy consulting business; although we still have a small amount of group business. However, even amidst such a mass exodus, each company must carefully examine the merits of the business in the light of its own circumstances. We have found, for example, that in the marketing of our other products, a strong background in pension consulting and plan analysis is a valuable tool. In fact, I am told by one consultant that the Metropolitan Life Insurance Company is still actively soliciting actuarial consulting business. Particularly for companies with a strong local presence, such a strategy can be successful.

Nonetheless, no company can be all things to all people. It must choose the fields where the maximum opportunities lie. This requires a segmentation of the market and a clear understanding of each segment.

INCREASING ROLE OF THE CONSULTANT

One of the new features of insurance company marketing is the national accounts group. It consists of highly compensated, well-trained sales representatives dedicated to sales and service for our major corporate and public pension clients. However, I have always been intrigued by the differences between the insurance company national accounts group and its industrial counterpart. The national accounts representatives of a firm such as Dupont would coordinate the sales and servicing of all its different products to a single major customer. In contrast, the insurance company may have a group insurance national accounts representative and a pension national accounts representative. The difference arises from the difference in audience. While the group insurance representative is, in most cases, speaking with the employee benefit director, the pension representative is dealing most often with the corporate finance officer or a national brokerage or consulting firm. In fact, there is a growing number of consultants and consulting companies which have sprung up or have become involved in the marketing of pension products. In particular, the nonparticipating guaranteed products business increasingly has become the domain of the consulting firms and newly created GIC brokerage companies.

Since actuarial consultants have traditionally been the keepers of plan valuation data, they have a natural role to play in the group single-sum annuity market. It is most often the actuarial consulting firm that is the primary point of contact for the insurance company. As a result, the actuarial consulting firms have become the brokers of single-sum annuity business. They solicit bids, evaluate them, and act as middlemen between the insurance companies and the corporate financial officers. They have often pushed the idea of participating annuity arrangements to counter their perception of insurance company conservatism. Whether or not this idea will move the market in new directions depends on cost and the authorization of such arrangements by the Pension Benefit Guaranty Corporation (PBGC) and the Internal

Revenue Service (IRS). However, a recent ruling by the PBGC indicates a willingness to accept certain forms of participation as acceptable guarantees of plan benefits.

Likewise in the GIC business, a whole brokerage industry has sprung up from coast to coast. It charges 20 basis points of the assets to do little more than secure GIC bids from 10 to 20 companies. With the advent of 401(k) plans, there has also been an increase in brokerage activity by certain actuarial consulting firms in the defined contribution market. By encouraging sponsors to make the rate the primary consideration, they have encouraged the investment community to view the GIC as a pure investment vehicle. As a result, there has been increasing interest on the part of both the brokerage and investment communities in the development of a secondary market for GICs.

Just as the growth of the actuarial consulting community changed the market for life insurance companies in plan services, this growth of the brokerage industry may have significant portent for the insurance companies in the GIC market. By making the rate the prime consideration, the profit margins in the single-deposit GIC contracts have been eroded by the increasing pass-through of investment risk premium to the client. A major dedication of marketing staff and expertise to this business no longer represents an efficient allocation of resources. In fact, the establishment of GIC "desks" at insurance companies and consulting firms emphasizes the effort to do this business at a lower level of expense.

The aftermath of the Baldwin-United and Charter Security crises has also focused attention on the credit aspect of GIC business. Large plan sponsors with hundreds of millions of dollars invested in GIC contracts are exhibiting a growing concern for the safety of their investments. This points out the startling difference between the corporate bond market and the GIC business. If a financial officer sees two bonds of equal maturity trading in the market at two different yields, he first would ask what the bonds' respective credit ratings are. Yet, the same financial officer will buy the higher yielding GIC with no questions asked. This may force the insurance companies to find other means than the traditional annual statement to defend their future solvency to a skeptical investment community. In fact, Standard and Poor's has begun to rate the claims-paying ability of the insurance companies. Other consulting firms are also jumping into the act, seeking to become the new Standard and Poor's or Moody's of the GIC business.

PUBLIC EMPLOYEE RETIREMENT SYSTEMS (PERS)

If one observes the recent actions of many of the larger U.S. insurance companies, it becomes evident that a growing number of firms are recognizing that an overweighting in the GIC market no longer makes sense in light of the other opportunities available.

There are at least two areas in which the insurance companies' share does not begin to match the potential penetration to be gained by a reallocation of resources. The first is the public employee plan sector. One prominent consultant in the PERS sector now estimates the assets of these plans at more than $300 billion, growing at a rate of 15 percent per year.

Until recently insurance companies suffered a variety of impediments to entering this market. Securities and Exchange Commission (SEC) registration requirements hampered the sale of separate accounts. Few PERS plans were tax-qualified. Many states prohibited dealing in annuity contracts with insurance companies.

However, the passage of the Employee Retirement Income Security Act of 1974 (ERISA) focused attention on the prudence of diversification. Additionally, the development of the real estate market by the large insurance companies offered an attractive vehicle to plan sponsors. As a result, the impediments have been progressively lifted from this business.

After years of estrangement, the entry into this market requires a mutual process of reeducation. This is still hampered by the inability of the insurance companies to divorce the asset management business from their annuity contracts.

Another recent development in the PERS market is the arbitrage opportunity presented to municipalities to purchase annuity benefits at corporate rates in the insurance market while funding the purchase at tax-exempt rates. Put in perspective, even a 10 percent share of the PERS market would be more than double the size of the current GIC market. As a result, Prudential, as well as several other competitors, has developed a marketing team dedicated solely to this PERS market.

INSTITUTIONAL ASSET MANAGEMENT

The other area where substantial improvement is possible is in the management of bonds and common stocks. It is in this market that a substantial investment of U.S. insurance company resources is currently being made. A 4-5 percent share in 75 percent of institutional assets converts to a 20-25 percent increase in market share for each 1 percent that the insurance industry can add to that total. In addition, business in pooled or single-customer separate accounts can be managed with far fewer people and with little or no strain on company surplus. Outside of development costs, the liabilities established will equal the assets under management. Therefore, strain won't be an issue.

However, the insurance industry has suffered from three essential shortcomings in marketing its services as investment managers.

The first, and perhaps most important, has been the lack of a strong track record. This may sound paradoxical in light of the long history of insurance companies as investment agencies. However, for investment personnel accustomed to the conservative assumptions inherent in insurance product pricing and results reported using the formats defined by the annual statement rules, competition with such standard indexes as the Standard and Poor's 500 Stock Index or the Salomon Brothers Bond Index has been difficult. The investment result, particularly in common equities has been disappointing. In addition, the disintermediation problems of the life insurance branch did nothing to enhance the reputation of insurance companies as fixed-income investors.

The second drawback has been the size of insurance company commingled portfolios, which have given the industry the reputation of being ponderous investors too slow to match the speed and efficiency of the smaller "boutiques."

In order to gain access to this market and establish a better track record, the larger insurance companies have purchased outside investment management firms. Metropolitan purchased State Street, Equitable purchased Alliance Capital and the Prudential Asset Management Company purchased Mercator Asset Management Company. Overnight they had an established track record to market and an investment arm independent of the insurance company's general account. In fact, the insurance companies were careful to announce that the newly purchased asset management team would not be burdened with the management of existing insurance company assets.

Having made the commitment to bond and stock management, some other changes have been necessary. To overcome the lack of marketing expertise in the pure asset management business, an augmented sales force was required. A sales staff trained in the standard insurance company products is not necessarily adequate in the money management business.

In order to sell new services, the sales force must understand the client's investment needs as well as the insurance company products. This has required skilled recruiting and a substantial investment in compensation. Likewise, the recruitment and compensation of the investment staff must reflect the level of competition, not just from other insurance companies, but from the firms who are the primary players in the asset management business.

Simply stated, we can no longer look at each other for models of organization, management, compensation, or marketing strategies. To win in this game means matching or beating the competition. To do anything less runs the risk of losing not only the business, but the best of your people to those who are willing to make the commitment.

MR. JOHNSON: The pension market in the U.S. continues to change, and there are many opportunities present in the market for both large and small insurance companies. The important thing is knowing your market, knowing your own strengths and capitalizing on them with an appropriate marketing strategy.

MR. KEITH S. WEAVER:

THE MARKET AND THE COMPETITION

The pension industry in Canada has three major participants: the distributors, the providers of administrative/actuarial services, and the asset managers. The distributors sell both plans and products. Life insurance salesmen are probably the largest group of distributors in the industry. However, there are others:

1. professional fund "salesmen" who are paid to hustle up funds for asset managers;

2. some consulting firms who are looking for business by contacting clients directly; and

3. others.

The administration function traditionally isn't seen as a competitive arena. However, last year, when my area lost a large 2,000-member client, I felt like a loser in a competitive contest. We are currently reviewing our practices and services to make them more attractive, and I believe there isn't going to be any arena that won't be competitive in the future. In Canada, plan administration is done primarily by insurance companies, consultants, and plan sponsors themselves. There are only a few good third party administrators.

The market for actuarial services is calm on the surface with cut-throat sharks lurking underneath. Each deliverer of the service feels obligated to criticize other firms for lack of quality and thoroughness. Of course, whenever consulting actuaries get up to speak about the consulting business, they like to take a shot at pension actuaries in life insurance companies for their conflict of interest.

Interestingly, the administration/actuarial market is not particularly price-sensitive in a traditional manner. To some extent, price is touted to be indicative of quality. This is something akin to the market for Rolex watches: you don't spend all that money for accuracy.

Last of all, there are the asset managers.

Looking at these roles it is interesting to note that only life insurance companies provide all the services under one roof.

ASSET MANAGERS

- Banks
- Trust Companies
- Investment Counselors
- Insurance Companies

The asset management market is very competitive. Presently the major players are trust companies, investment counselors and insurance companies.

I have included banks, however, because rumor has it they will be allowed to enter the market shortly. The federal government's recent policy paper on the trust and insurance industries has certainly suggested a loosening of the barriers separating them.

Some of us are speculating that the changes will simply give the nonbank financial companies a temporary opportunity to set themselves up as broad-based financial services companies. But only for "5 years." At that time, the bank act will be up for review, and perhaps the banks will be allowed to enter the nonbank part of the market. Please note that in Canada, banking is national with perhaps five companies providing the vast majority of banking. At one point, branches used to be on every corner, but now these are being consolidated with automated teller machines covering customer services.

If they are allowed to do so, I think we will find they would have an easy time entering the large plan market. The banks might be viewed as potential participants in the small-plan market with their branch network and access to small business. However, they will find this difficult because their branches are not organized in such a way as to deliver new and technically complicated products. We can only wait and see what happens on this front.

Let's look at where all the business is. These numbers are from the 1982 Statistics Canada Publication: "Pension Plans in Canada."

Custodians of Plan Funds

Funded By	Plans	Members
Insurance Cos.	10,673	619,609
Trustees	4,331	3,181,365

It is clear that insurance companies dominate the market but only by number of plans. On the other hand, 84 percent of plan members are covered by plans funded by trustees. These are primarily defined benefit plans.

This size issue is shown more clearly by the following comparison based on numbers from the same Statistics Canada Publication.

Average Number of Members Per Plan

Funding Medium	Average
Group Contracts	25
Deposit Administration	59
Separately Managed Funds	122
Corporate Trustees	544
Individual Trustees	1,153

For each funding medium, the average number of members per plan is shown. Group contracts would typically be guaranteed annuity contracts which, for the large part, are no longer sold. Deposit administration contracts would include both allocated and unallocated plans.

The other media are self-explanatory. The progression of average size from group annuities (GAs) to trusteed funds is very interesting.

Exhibit 1 shows the plan assets under management by company. Please note that the vertical axis should be in billions rather than millions. Over time the insurance industry has lost market share. On the other hand, so have trust companies. The trust companies, though, would be getting the bulk of the custodial work from the investment counselors. As more life insurance companies start aggressively selling their services as professional fund managers, market share should shift somewhat. However, there are forces that are working against this. For instance, as with most institutions, life companies will have difficulty in retaining good, qualified fund managers. When good fund managers leave, they often take business with them.

THE SMALL BUSINESS MARKET

Life insurance companies traditionally are strong in the small business market (Exhibit 2). The total number of businesses under 100 employees is roughly 700,000. However, once you exclude shell corporations, those in bankruptcy, and so on, the total number of businesses reduces to about 283,000. This can be subdivided by size into those with 2-9 employees and those with 10-100 employees.

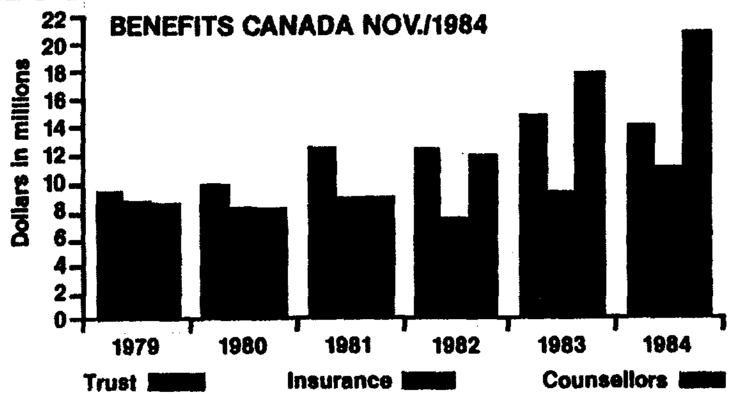
Looking at the 2-9 segment of 207,000 businesses, there are 96,000 proprietorships and partnerships and 111,000 incorporated companies. Proprietorships and partnerships are not a good market for pension business because of legal constraints on the owner. Of the small corporations, it is not clear how many are healthy enough to afford pension benefits. In addition, shareholders are restricted on these small plans in the value of the benefits they can purchase. The potential for pension business, while not great, is fair. The restrictions on proprietorships and shareholders may be removed by the recent budget proposals.

In the 10-100 segment, 68,000 businesses are under 50 employees and 8,000 are above 50. For pension plans, a plan with over 50 members starts to be a good-sized plan. Contributions for a 50-life plan would be in the order of $100,000 per year and assets would, on average, be about $1 million. These clients are excellent candidates for plans. Current penetration is likely higher than in the other segments, and transfers of plan assets on new sales would be more common.

Subdividing the 10-49 segment further by years of business, there are 33,000 companies in business for 2-15 years and 35,000 over 16 years. The younger companies would tend to be less stable and as such would be only a fair market for pensions. The older companies are excellent candidates.

EXHIBIT 1

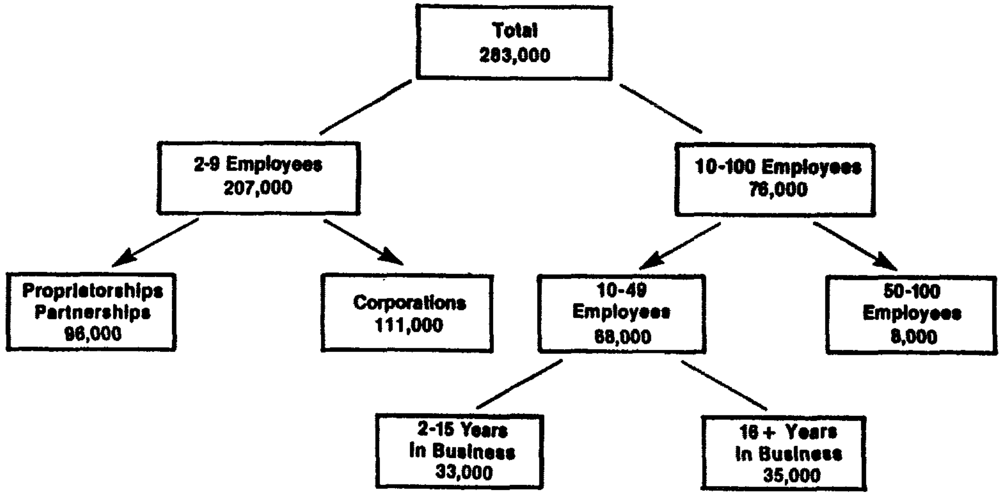
CHANGING ROLES OF ASSET MANAGERS



Source: Benefits Canada

EXHIBIT 2

SMALL BUSINESS MARKET



Generally, this end of the market is fertile ground for life insurance companies where their agency force can have fairly easy access to these companies. Assuming the previous figures for number of plans were correct, not more than 5 percent can have pension plans.

PRODUCTS

Exhibit 3 shows the products offered by life insurance companies.

Money purchase plans now being sold have individual allocated funds. Interest is guaranteed although other types of funds are available. This group of products includes not only registered pension plans (RPPs), but also group registered retirement savings plans (RRSPs) and deferred profit-sharing plans (DPSPs). Much of the RPP business sold at the lower end is sold as a tax-deferral tool. In light of the recent budget announcements, this market is now somewhat suspect. Perhaps in its place will be an employer-sponsored locked-in RRSP with employer matching contributions. We have not had enough time to study the impact of the budget on larger money purchase plans.

The old GA products are not being sold any more, but there are still a fair number of them remaining. GAs were used to fund both money purchase and defined benefit plans.

Employee benefit plans (or EBPs) also fit into this category. EBPs are popular with nontaxable organizations. However, their end is near, again, as outlined in both the Wilson and Lalonde budget papers.

The fully serviced defined benefit plans are, typically, "packaged" plans with fixed-fee schedules. At the low end, the market is really a tax deferral tool for executives. Benefits are provided at the maximum levels and as many loopholes as possible are built into the plan. Larger clients want simple, cost-effective, and well-serviced plans.

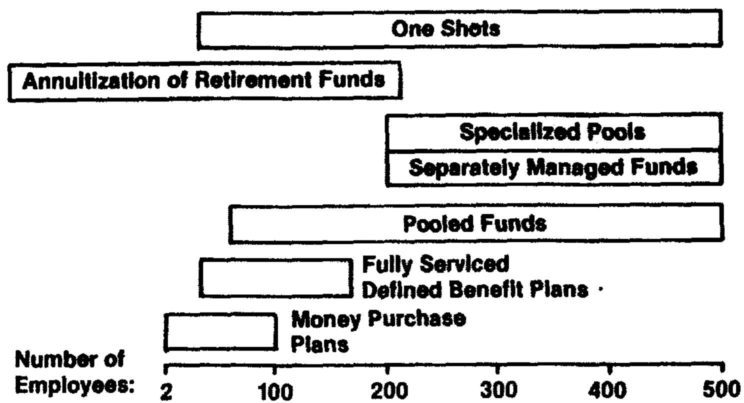
Mr. Paul McCrossan mentioned that he could see, because of the proposed tax changes in the budget, a trend developing to combination defined-benefit and money-purchase plans (MPPs). The impact on insurance company plans may be small but insurance companies may be able to gain access to some of the MPP business. My company, ManuLife, currently administers several large voluntary-only plans--these are supplements to the sponsors' basic defined benefit plans.

At this point, the products become unbundled. At the lower end, insurance companies will provide both administrative and actuarial services. In any case, the focus is on fund management. The pooled funds offered are fairly standard: equity, bond, mortgage, and diversified.

Clients will typically start to consider separately managed funds at about the $5 million or 250-member level. At this level separately managed funds are customized only to a limited extent. Fund managers would manage the separate fund as part of all the other smaller separately managed funds and pooled funds. Only when the fund gets into the $15 to $20 million range do fund managers consider anything substantially different for them.

EXHIBIT 3

PRODUCTS



The 500-life limit does not mean anything in exhibit 3, except that my picture has to stop somewhere. At the very large end, companies will have portions of their funds separately managed. These companies normally have a series of different fund managers.

Similarly, specialized pools are offered for large clients to deposit portions of their funds into them. Examples of these pooled funds are: American stock funds, real estate funds, and oil and gas funds.

Life insurance companies presently have a stranglehold on the annuitization market. However, the market is very competitive--particularly on rate. Annuities are becoming commodity products. They are easily available and don't require sophisticated expertise to be sold. One of the challenges facing specific life companies is how to keep the funds released from their own plans--particularly from MPPs.

One shots are offered across the market. At the small end, they are used primarily to guarantee accrued benefits on plan terminations. At the large end, one shots are used to release surplus into the plan and perhaps provide a better match for assets and liabilities. One shots may be very complex. They must be able to reflect the diversity of plan provisions in virtually any defined benefit plan.

DISTRIBUTION

I would now like to turn to distribution systems. Exhibit 4 indicates where the various distributors are positioned in the market.

Traditionally, life companies have depended heavily on agents to distribute their products. I am also including, in this category, agents of other companies.

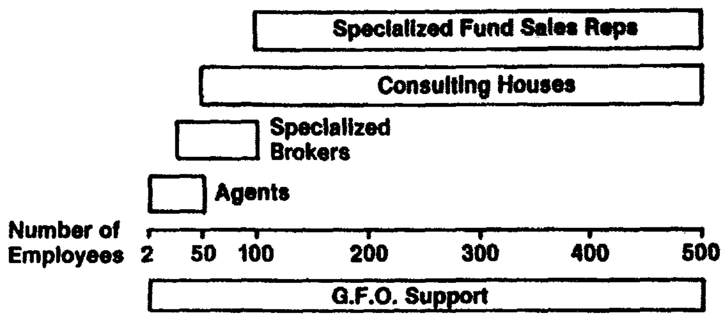
The strengths of this distribution vehicle are threefold. First, it has excellent access to the specific markets that it is involved in, and it is strong in the small business market described earlier. Second, good business agents are excellent salesmen who see themselves as professionals and require support to maintain that level of expertise and image. Third, it is relatively easy to turn agents on. It may be expensive perhaps, but certainly it is clear what the incentives are for them.

However, as a source for pension business, agents are not without fault. First, their technical knowledge of pensions is weak. They need support during the sales process and particularly in the servicing of the cases. Second, they do not have access to all the markets that are desired. In fact, it is difficult to control which markets they get themselves into. Agents will find the markets that give them the quickest and most profitable return on their activities. They change markets quickly, depending upon which sales are easiest.

I must add, however, on these two points, that some companies try hard to manage these problems. They train their field extensively to gain access to specific businesses or individuals. They then direct them into those markets. My point is not that you can't do this but that you are working against a natural phenomenon.

EXHIBIT 4

DISTRIBUTION



The next source of distribution is specialized brokers. These brokers have much of the experience and knowledge that the typical agent does not have. They are comfortable in these markets, and they are comfortable with what they sell. A different level of support is required by this source. The issues the brokers raise tend to be very technical, and they tend to drive a harder bargain in specialized arrangements. They market their own skills as specialists almost to the point of being plan consultants. One office I know even has its own actuary who is given actuarial work on the business in that office--for instance, costings and valuations. Some of these brokers can be quite large and offer a large range of services to their clients. In fact, some are national in scope and have hundreds of clients.

Specialized brokers like to service their clients well--almost to the point of taking over some of the administrative functions. This is the exact opposite of the agent who likes to ignore the case once it has been sold and once he has collected his commission. This latter characteristic is similar to what happens on a typical individual life insurance sale.

For specialist brokers, brand loyalty is weak. As a result, relationship building is important. However, specialized brokers have access to the medium-size market that is so desirable.

Moving up the spectrum, we get to consulting houses as distributors. Consulting houses are starting to have access to the smaller companies. It is not clear if they will be successful. The orientation is different: where the specialized broker knows his commissions and offers his services based on that knowledge, the consulting houses try to sell their own services at variable costs to the clients. If clients understand this, there normally isn't a problem; but, if not, the consulting house will quickly get dumped.

For life companies, consulting houses provide the source for pooled fund business and one shots. The consultant reviews investment performance and helps in choosing new fund managers. If the consultant knows that the life company offers fund management, he may ask for a proposal.

The problem with this approach is that it is hit or miss. Consulting houses are not so much a source, but a contact. To get around this problem, some life companies are hiring specialized pension fund salesmen to gain access to the larger clients directly. These salesmen need to work closely with fund managers. Having the fund managers along on a sales presentation increases the close ratio substantially for that sale. However, if they do too much of this sales activity they are no longer fund managers.

The support referred to previously is given by the traditional group field office (GFO). The GFOs try to develop group agents to sell group products. For agents, they provide a lot of support in the sales situation and service the client largely by themselves. For specialized brokers, they try to make the contact; they try to build the relationship; and they trouble-shoot when there's a problem. It's the contact that's important for the consulting houses along with a certain amount of relationship building. Sometimes the pension fund salesman is located within the GFO. However, if he isn't, the GFO needs to work closely with the salesman. All these roles are difficult to fill completely, especially when the GFO is expected to cover the life and health market also.

TRENDS

- Access to large clients
- Blurring of financial boundaries
- Trend to money purchase
- Legislation driven

The market and industry are changing gradually. I believe that the life insurance industry is trying to move upscale in the market. Insurance company fund salesmen are showing up more often at presentations by fund managers. Also, several companies have already set up investment subsidiaries to give the appearance of being investment counselors. Examples are Sunimco at Sun Life, Mucana at Mutual, and ManuVest at ManuLife.

The boundaries of these markets are blurring together. What used to be individual annuity business is now retirement annuity business. What used to be group annuity plans are now looking like individual RRSP contracts.

Guaranteed products are now being sold as investments. The implications of this are that life companies have to view the whole market as one and not as traditional segments, each neatly packaged.

There is a trend to MPPs away from defined benefit plans. This is driven by the trend to individual benefits and flexibility to the employee. For instance, some defined benefit plans are becoming combination defined benefit and defined contribution plans. Guaranteed employer contributions are calculated as a percentage of employee contributions plus interest. The benefit given at retirement is then the greater of the defined benefit and defined contribution benefit. Overall, it is conceivable that the trend to individualization will push the market into RRSP products with less restrictions than RPP products have.

Finally, the pension industry is being driven by legislators. The recent budget, for instance, has made RPP-MPPs less attractive than before. No longer can RPPs be used to increase tax deductions. EBPs will be restricted if not curtailed completely. Also, each province is getting into the act. Each has legislation with its own wrinkles concerning guaranteed interest on employee contributions, unisex rates, minimum vesting schedules, and more.

As a result of the legislative activity, the stakes become high because the market can change rapidly without notice. Life companies are at a disadvantage because their fully serviced products tend to have fixed prices and costs cannot be passed on quickly.

PENSION ISSUES FACING LIFE COMPANIES

- Access to all markets
- Distribution and manufacturing costs
- Internal competition for resources
- Ability to respond quickly

Life companies don't have it easy. There are several issues we are facing. First, we need to demonstrate that we can have access to all the markets. No longer can we depend on our own agents to do this for us. We need to develop alternative distribution channels. In the past, we have depended on our agents to provide the hustle necessary for the sale. However, with new distribution channels, this hustle will have to be generated throughout our organization.

Second, life companies are continually faced with high distribution and manufacturing costs. It is not clear whether we can afford to pay our distributors enough to get the results and the access to the markets that we want. Our distributors have traditionally been paid well for the value they add to difficult sales of life products. Can we produce products priced competitively and still be profitable? We must recognize that some of this business is high volume transaction business, and our costs per transaction must be low. Again this is a new way of operating for life companies. There is a rumor that at least one company has decided to give up on the small pension plan market. It decided its costs were double its pricing assumptions with little chance of reductions except with large investments in new systems and so on.

Third, we are faced with an organizational problem, particularly with the field. Internally we are forced to compete with other business units to have our products sold. Group life and health, individual annuities, and insurance all want the field to sell their products. Each product is different: compensation, expertise, type of sales, servicing, and so on. Will we have to manage the field to specialize in products? On the other hand, does this jeopardize the potential of cross-selling? Can GFOs be adapted to support this diversity properly? The distribution issues are critical for pension business.

Finally, companies must be able to respond to the changing market quickly. The legislation will drive us to provide more and varied services and to do so quickly.

MR. JOHNSON: When comparing the Canadian and U.S. pension markets, they are much as one might expect, in that there are both similarities and differences. There are differences in the markets themselves in terms of size, trends, and so on, but there are striking similarities in that both the Canadian and U.S. pension markets represent attractive market opportunities for insurance companies.

PANEL DISCUSSION

MR. DONALD S. GRUBBS, JR.: The Simplified Employee Plan Individual Retirement Accounts (SEP IRAs) are relatively free of the burden of government regulation. Is this market not a good opportunity for insurance companies? Why have insurance companies tended to avoid this market?

MR. BARNEY: Most insurance company products have been associated with high commissions and a large mortality component making them unsuitable for people looking for accumulation of capital. However, the merger of insurance companies with brokerage houses makes it possible to approach this market not through life insurance but through mutual funds and capital accumulation products.

MR. BRIAN C. TERNOEY: With the large increase in annuity buyouts from pension plans and in GICs, has there been any problem with some insurance companies running out of capacity?

MR. BARNEY: Capacity depends largely on interest rates and surplus strain and in the GIC markets a fairly large volume of business can be placed with little strain in 1985 due to current conditions. Prudential used an aggregate test to justify reserves; in effect, GIC strain was covered by redundancies elsewhere. With regard to single-sum annuities, competitive pricings tend to be predicated on the incurral of a significant level of reserve strain.

MR. JOHNSON: We, at Pacific Mutual, have not written enough business to have a problem with strained capacity.

MR. H. CLARE PITCHER: I believe Mr. Weaver mentioned that it is difficult to retain good investment managers. Why?

MR. WEAVER: Consulting firms are attractive to investment personnel because they offer independence, high pay, and a high profile. It is hard to compete against these points. To offset this, some companies have set up subsidiaries and allow investment managers to participate in the profits.

MR. PITCHER: We also have a subsidiary which was developed to compete with the investment counseling firms and to get a share of that market. This way we try to have the best of both worlds: the independence of a counseling firm together with the access to the expertise and resources of a large parent financial institution.

Mr. Barney mentioned a trend, in the United States, away from actuarial and record-keeping services for pension plans. What sort of trend do you see in Canada, Mr. Weaver?

MR. WEAVER: On money purchase pension plans, insurance companies tend to do the record keeping; there are not many good third party administrators in Canada. Services tend to be part of our contract, and presently, my company is developing a new system for this purpose.

With respect to actuarial services, I am not ready to give up yet. I think there is room in the market for a provider of simple low cost actuarial services.

MR. PITCHER: Many clients in the 20- to 100-member category want the full package of services, and insurance companies are in a good position to provide this. However, are you actively marketing actuarial services on a stand-alone basis?

MR. WEAVER: No, we are not.

MR. BARNEY: Insurance companies have been traditionally uncompetitive with the compensation packages of the investment houses. In order to be competitive, insurance companies may have to recognize salary differentials based on the source of their primary competition. This also has reference to the level of actuarial salaries for asset-liability managers and with regard to the increasing importance placed on the role of the valuation actuary.

MR. CLAY R. CPREK: Why have Canadian companies been so competitive in the one-shot annuity pension buyout market?

MR. WEAVER: I am not sure. I do know that, several years ago, surplus strain used to be severe, but because strain on Canadian business tended to be low, Canadian companies could invest in U.S. business. With the changes in the valuation laws, strain is not a concern--even on U.S. groups.

MR. BARNEY: The major U.S. companies were in the upscale market while the Canadian companies got into the small- and medium-case market due to an absence of a strong interest in that market by the second-tier U.S. companies. However, the Canadian companies will begin to face stiff competition from some American companies such as Provident National.

MR. ROBERT M. ROSENBLAT: Although I am now with Metropolitan Life in Toronto, I was until recently responsible for pricing U.S. one-shot annuities at ManuLife. When I was there, we found that competition started to come from companies who previously had not been big players in the market. Since we were not following an "in and out" strategy and our pricing practices had been consistent during this period, I assume that the advent of dynamic valuation assumptions made it easier for a number of U.S. companies to become competitive in this market. I could also speculate that any U.S. company that demutualized might find it easier to price more aggressively.