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AGENT IMPACT ON INDIVIDUAL LIFE AND ANNUITY PRODUCT DESIGN AND SALES SUPPORT

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MR. WALTER N. MILLER: Twenty years ago two things would have characterized such a session at a Society of Actuaries meeting. First, it would never have been on the official program of the meeting. Second, if the subject were to be discussed informally, the group would have been very small.

Twenty years ago, the agents were captives. They were our agents and all the business they wrote they gave to us. Competitive considerations, both inside the industry and from outside the industry, were minimal. Actuaries did everything themselves. Agents were a necessary annoyance every once in a while when it came to product design and pricing. Most of us thought of agents as those nasty people out there who kept wanting more.

The two main influences for the past twenty-years are an enormous increase in the level of competition from both within and outside our industry and greatly increased agent independence. Agents are now more aware that they can be independent and can have some clout and leverage. They have every right to do this. Being a successful life insurance agent is a tough, demanding job that takes a high degree of knowledge, concentration, drive, ambition, and an ability to shrug off what are often some very discouraging circumstances.

How can we better support our agents and how can we do more for them?

New York Life has invested an enormous amount of time and energy in communicating with agents and maximizing the opportunity for agents to have an impact on many of the matters we are discussing. We pick up the phone when it rings, and we open our mail. I mean that from a

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standpoint of attitude. There are a number of people in home offices scattered around the country who, when the phone call or the letter is from an agent, give them either less attention or a different sort of attention. Try reading the letter. Try really listening to what his concerns are.

Everyone of us associated with product design and pricing has been bombarded with a good deal of competitive information from our agents about what the other companies are doing. One important, simple way to open communication a little further is to make a business of asking your agents to be your competitive eyes and ears. Keep telling them that you depend on them for information on what the competition is doing, what the agent hears about it, and how effective it is. If you don't ask, and emphasize, you're going to be subject to a considerable degree of selectivity. The information you'll get will be valuable, but it may not be all the information. If you ask, you might get more.

Like many other companies, we have what is called an Agents Advisory Council. We have various honor groups, and each of these groups elects a number of agents to the Agents Advisory Council to serve a one-year term. Through the use of an organization that has built up over the years, they then go through a very intensive campaign amongst the entire field force, and send in all suggestions and inquiries to the home office. The people who the agents really bombard are the Agents Advisory Council representatives themselves.

Then they all come into the office for a full week in April, having screened, categorized, and classified all the suggestions. The first four days are an intensive round of discussion among Agents Advisory Council representatives and the concerned home office people. They talk further about resolving these issues and identifying the most important ones. These are then discussed at what usually is a four hour meeting of the agents with the company's executive officers on Friday morning of that week. A transcript of that meeting is subsequently published and distributed to the entire field force.

Most of our agents who have been involved in the process would say that, while they don't totally agree with all home office programs and policies, and products and pricings, it means something to find out what the motivation and reasoning is behind some company actions. Understanding what the other person is doing, and why, is an enormously important forward and constructive step in communication.

Increasingly direct agent involvement in various matters of product design has been used. They work with the people who are actually developing the product, usually offering input at the formative stages. If you can get good people with some firing-line knowledge about the products being developed or markets being revised, the input can be an enormous help.

We've also run agent attitude surveys. Some of them are pretty long and complex, probably overly complex. Not very many people in our company, in either the home office or the field, have ended up putting much stock in what comes out of these.

Agents vote with their business. They vote in deciding where they want or feel they have to place the business that they write. How much business are your agents putting outside the company and why are they doing it? It's not easy to obtain good information , but it's worthwhile to constantly question and probe, regardless of what you hear.

In the fall of 1982, we cut our term insurance rates to something reasonably close to then state-of-the-art rates, fueled by the tax law just passed. Our term sales immediately doubled. In the beginning of 1984, looking at changes in tax laws, we reasoned logically that we couldn't support the prior level of term pricing and also that all other stocks and mutuals would be affected by exactly the same forces that we were. We reasoned that when we raised our term rates, everybody else would have to raise their rates by about the same amount and at about the same time. This set a record for naivete that may be equaled but never surpassed. When we raised our rates and nobody else did, our term business was cut in half, almost immediately, as soon as back dating periods ran out. An interesting conclusion, though is that New York Life agents as a group will place about half the term business that they write with us regardless. The other half that they write is volatile business that they will place with us when our rates are perceived to be reasonably competitive, but will feel impelled to put outside when they perceive that our rates are not competitive. A full 50 percent of the nonterm business that our agents write is probably not moveable or volatile in that sense, but it's a good illustration of agents voting with their business.

We're certain that we're better off for doing a lot of these things. We have a big problem in a company with 9,500 active agents spread throughout the country, working at all different levels, in all sorts of markets. Who really represents the field force? Agents are not a monolithic group, an important thing to understand when we talk about agent impact and communications with agents. There are many strata of agents and sets of interests in a field force of any size.

If agents vote with their business, companies are going to have to improve productivity and find more and better ways of justifying the cost of running the agency system and making it help support itself. We must broaden the base of business to help support the ongoing overhead costs of running and preserving an agency system.

A better product is one answer, but there's some limit there. You cannot always be number one, and have the best illustrations and products, especially since some of us still think that it would be nice to try to make some money.

More compensation is certainly a way to help broaden your business base and attract more of the business that your agents are writing. There are some limits from the standpoint of business judgment. We have to try to write profitable business, and the New York companies have Section 213 to think about.

Better support services to the agents are enormously important, but once again a cost item with a significant learning curve.

MR. FRANK J. BUCK: Mr. Jerome Schwartz is the president of an agent-owned reinsurer, Executive Life of Arizona. He started out twenty-five years ago as a life agent and a securities dealer. He then ran an agency for a while and became the sales and office manager of a marketing organization. Prior to starting Executive Life of Arizona, he was the Executive Vice President of a public financial services organization with six hundred agents.

MR. JEROME SCHWARTZ: Relationships between agents and actuaries have changed dramatically over the years. I've had the pleasure of dealing with a number of actuaries over the last five or six years that have been extremely creative, that have recognized the changes that are in the industry and that have allowed the agency force to participate the way we need to participate.

I'm an entrepeneur. I wanted to create a legitimate agent-owned reinsurance company. One that was owned and controlled by the agents and had a reinsurance treaty that gave them a significant piece of the action. I'm an entrepeneur.

I approached Fred Carr at Executive Life in November of 1976 with the idea. This was not an idea that had never been promulgated prior to that time. But it hadn't been done exactly the way we did it. There were some reinsurance companies structured in various states, a lot of them in Arizona, that were owned by credit life situations or automobile dealerships. A couple of life companies were structured so the emerging profits were put into the holding company owned by the agents. But it wasn't a true reinsurance company, a true insurance company that would be able to capitalize ultimately on its efforts.

We shook hands on a deal on February 14, 1977. Executive Life's consulting actuary, Fred Carr, and I dealt with Chuck Bentzin's firm in Arizona to help us put together the Arizona Reinsurance Company.

Because of regulatory problems I went from February of 1977 expecting to be in business in May of 1977, to going in business on July 2, 1979. We proceeded to go broke, and had lots of aggravation and problems putting it together the way we wanted to put it together. We wanted something that really could work. Executive Life stayed with it, Fred Carr stayed with it, and we all fought it. There was no financing on the part of Executive Life for this program.

Executive Life does not own a single share of the common stock of this life insurance company. They own some nonconvertible stock; the stock holdings are owned by us. There are now sixty-five stockholders in that first company. I own 20 percent and they own 80 percent.

The information that I am communicating to you today is public record. Anybody can put one of these together. There are certain important precepts for you to follow. The company must be owned and run by the agents, and there's got to be a boss who is an independent entrepreneur and promoter that is operating it.

We choose whether to invite somebody from Executive Life to our stockholder meetings. We vote on what we want to do.

My income does not come from Executive Life of Arizona or the other reinsurance companies that I have put together and own. None of that income is diluted. All of the income or gain goes into the surplus of that company. From our first organizational meeting agents that came paid their own plane fare, their own hotel room, their own food, their own car fare, their own everything. This has always been the case, and we have virtually 95 percent or better attendance.

The mistakes that I have made have been selling stocks to a couple of agents who were captive agents, housed within an agency of a major life insurance company. They were not entrepreneurial people. They expected hand-holding that wasn't going to come from this approach, and they weren't looking for the back end and didn't understand the back end.

Recently, much of that has started to change. A number of major agents of large life insurance companies that were previously housed have now moved out of the housing. They are taking on the risk of overhead and are looking forward to participation in the type of company we have put together and worked successfully for the past five or so years.

In 1982 we did a secondary offering, brought in another thirty-five agents, and had about sixty shareholders of the company. A stock purchase agreement goes with the transaction of the general agents agreement. If an agent does not produce the amount of minimum premium that he or she is contracting to produce over a long period of time, or doesn't have the level of persistency that the agreement calls for, the stock can be bought back at book value - no multiples, no GAAP values, just pure, net book surplus on a statutory basis. The value of the company has grown and few agents have chosen to not produce business and maintain the business at a high level of persistency.

Our fifth year of operation ended in 1984. We are attempting right now to get a Best's rating. The company has 1.2 billion dollars of insurance in force. We started out with 50,000 dollars of surplus and 100,000 dollars in capital. We now have 2.2 million dollars of surplus and about twelve thousand lives. Last year's premium was 22 million dollars, 14 million dollars in new, and 8 million dollars in renewal. It's compounding on us. We will probably pay for 18 million dollars of premium this year.

The average premium production is somewhere better than $200,000 of paid. We only work on paid commissions.

We are a business; it's a bottom line oriented set of circumstances and we are looking to capitalize our efforts in a number of years.

We employ Coopers & Lybrand as an actuarial tax counsel to provide an independent valuation for us. We do that on an on-going yearly basis.

The stockholders chose at the end of 1984 to continue their company and to do a few things in a business plan that will guide us through another five years of operation. In effect we have a ten-year plan.

In 1983, I started another agent-owned reinsurance company. We were very creative in our second company called ELAR-2. We have a totally distinct group of thirty-five agents that we sold stock to. We just completed a secondary offering, moving a lot quicker in this company. The first six months of operation produced 4 million dollars in paid premium. There will be about sixty agents. We're basically cloning what we did in the first company.

Executive Life has six agent-owned reinsurance companies and I am involved in three of them. In two of them, I own 20 percent of the shares, and in another one, I am the operating officer. A marketing group owns that particular company and sells the stock. There are three other agent-owned reinsurance companies. Executive Life distributes through marketing groups. There is no agency department. We create the products and the distribution. There is no fronting and no annualization; nothing is involved with cash flow. Those of us at the head of the marketing groups have an opportunity to recruit a significant number of agents, and produce a significant amount of premium.

Executive Life paid for about 200 million dollars in new life premiums in 1984 and about 850 million dollars of annuity business. Out of the 200 million dollars in new life premium, the agent-owned reinsurance companies probably contributed 70 percent. That's less than four hundred agents producing that amount of premium. So, the success of the particular approach has been significant for Executive Life. The reinsurance treaty is fifty-fifty. We retrocede amounts over our retention. We can make a choice about our retention and all of the other things in running our company as a business. We have the ultimate responsibility. We can go public; we can sell to Executive Life; or we can sell to one of you. We can sell for the present value of the future profits of the block of business. Our persistency on the business exceeds 93 percent over the five years. The value of this company is significant, and the cost to the agent was minor in relation to the value that he or she now has in the company.

The creation of the products and the marketing and distribution systems of the products are almost uniformly created by a marketing group like mine. We present it in concert to Executive Life; their actuaries do the asset share studies on the products; and we then determine what the commission levels will be. This is a problem for us because our agents are keen on the value of the profits within the product because they own a piece of it.

At our first stockholders meeting in 1979, we had one death claim, and our retention was 15,000 dollars. The agent who had the death claim lived in California, and he and his wife were there. I gave a very serious discussion about the company and how it works. They had never heard it before. I handed them the statement and showed them where the death claim was. And I said the agents pay their own death claims in this company. I handed Elliot a bill for 7,500 dollars and Mary Anne a bill for 7,500 dollars and they weren't quite sure whether I was serious or not. Neither was anybody else in the room until I started laughing. We have had very few death claims. Our persistency has been excellent, our mortality has been excellent, and the company's profit has been very good.

MR. LESLIE L. DURAND: In many companies, product development is like five people making toast. One person gets the loaf of bread. Another one puts it in the toaster. The third one pushes the button. The fourth one pulls it out. The fifth one comes along and butters it. Then they take it up to the president and he wants jam on it so they throw it away. All of our companies have great ideas. The question is what to do with those ideas. It's amazing how much time, effort, and money is spent on the research and development function of creating the product. We can't sit back like we did twenty years ago and say as soon as the system's ready, we'll give it to you.

At the inception of the M Group in 1971, there were two very large producers for a Canadian company. They were told by their immediate carrier that they could only produce a total of 800,000 dollars of first-year premium. The company was not willing to absorb the surplus strain associated with higher production. Did that company really understand who their customers were? This brought these two individuals to Security Life. They had made some strong relationships through industry circles with Security Life's agency vice president. They wanted to do business with Security Life if we could deliver a product that suited their needs and marketplace.

In 1971, the first product was jointly created by Security Life of Denver and its agents. The product was called professional whole life and was a Section 79 contract. This was when you supposedly could allocate the parts of a whole life contract to the term and permanent pieces. Two weeks after the product was complete the IRS came out with a new regulation. We could have abandoned the venture, but we decided to proceed.

Subsequently, Security Life arranged for Integrated Resources to be responsible for the recruitment and development of agencies with Security Life of Denver responsible for the product development in conjunction with the agent. This culminated in 1974 with a new Section 79 product. It also resulted in Integrated Resources bringing seventy-five agencies to Security Life.

The relationship with Integrated was ended in 1979. But it was important in that it brought us the nucleus of what is known as the M Group, which is our agent-owned reinsurance company. The M Group is not owned by Security Life. We have preferred stock in it, but it's easily bought out by the owners. It is completely run by the agents. Security Life provides administrative services. The Integrated Resources experience also was the first time that Security Life aggressively developed a product for a given marketplace.

Once the Integrated Resources relationship had ended, the same two producers came back and said because they were still significant producers, they wanted to engage with Security Life in the development function. They wanted some ongoing participation in the long-term profitability of the organization. And in a lot of ways what they were saying is not really any different than key employees within our own company. Such things as stock options and performance bonuses have been created as ways to keep key employees. Because the agents were key producers and key customers, they wanted to put together a long-term incentive that could bind us in a partnership, allowing us to share in the long-term profitability of the business.

Security Life thought it appropriate to require a much larger group of agents to justify the things to be done to create the necessary products. A partnership was formed at the end of 1978. There were eighteen agencies involved. It was put together partially for the long-term potential of excess profit, to be shared based on the quality of their business. It was also put together because of the relationships that had developed over the years. There was a high level of mutual trust. There was a high level of openness and sharing. I think this is the critical factor that has led to the growth and success of the M Life Insurance Company.

Security uses the phrase M Group, M Life, M Managing Partners, all kind of phrases to refer to this organization. But it wasn't until 1981 that it actually became a corporation. The M Life Insurance Company is part of the M Corporation, a Colorado corporation. The original partnership that was started in 1978 with those eighteen agencies became the founding shareholders. It is completely owned by the agents. They make the decisions. In fact, in 1983 a decision was made that they would also market the products of Pacific Mutual. We share the same producers openly, reinsure business into the same organization, and have a joint venture that has increased the significance of all three players.

Why does this relationship work? Was it created as a tool for agents to share their business, or were there principles other than the pure economics involved? All too often we have a very narrow view of our industry and our business, and we look at what we're doing from the perspective of an insurance company as opposed to a general business. These leading agents were saying that they wanted to deal with us as businessmen. They wanted to deal one-on-one by sharing and not being dictated to. They were looking for carriers that would treat them in that regard.

A good number of producers came from eastern mutual companies and were tied into the captive agency relationship. They wanted to break away from that and to be compensated and rewarded on their efforts, not on relationships in an existing branch office or general agency or other housing relationship with a larger company. They wanted contracts that a businessman could be comfortable with. About ten years ago, the prohibition against brokering business or moving business or dealing with multiple companies was a problem with some of the old-line companies. Agents wanted contracts that they could enter into that affirmed the relationship that had developed over the years. They did not want to put a great deal of business with a given carrier and one day be booted out.

Agents wanted flexibility for growth exemplified by the addition of Pacific Mutual to the relationship in 1983. The addition of a mutual carrier allowed other products to become available to them that Security Life of Denver could not provide. They wanted to deal with carriers that would be open to the addition of other parties.

They wanted the unrestricted exchange of ideas with peers. The members of the M Group are all highly successful independent agencies. Many of them have a corporate structure. Many of them do joint case work together. Many of them want to open new markets. To them, the ability to get together two to three times a year with their peers and open up these new territories not only means significant profit opportunities to them but also opportunities to grow in their business place. Security Life and Pacific Mutual get involved in their semi-annual marketing meetings to participate and hear what they have in mind for future developments. However, they also have a once a year shareholders meeting which is closed to the parent companies, unless we are invited. And typically, other than our general counsels, no one is there.

During the last two tax revisions in Washington, the M Group was instrumental in forming an organization called the Line PAC. Many members of the Executive Life producer groups are also in that organization. It's a political action committee that was put together to bring forth in Washington issues important to them and to fight for their ideas. They created a very powerful voice in Washington and have joined with other significant members of the insurance producing industry in order that they may be an instrumental force in getting legislation not detrimental to their primary business.

In 1980, the members of the M Group produced approximately 6 million dollars in first year premium. In 1982, that number was 20 million dollars, 1983, 50 million dollars, and in 1984 it was in excess of 50 million dollars of first year premium. To put that in perspective, in 1980, 50 million dollars of first-year annualized ordinary premium would have been the twentieth largest company in the United States and Canada. Today, there's approximately fifty agencies with about 230 agents involved in those entities.

The business that they produce also has some significantly different characteristics. The average size in 1983 was 247,000 dollars as compared to 80,000 dollars for the rest of Security Life's agencies and 26,000 dollars for the industry. Average premium per case was 8,700 dollars as opposed to 2,600 dollars for the rest of our agents. Premium per thousand was thirty-six dollars. The industry average is eight dollars. Their persistency rate was 97 percent and approaching 98 percent for first-year persistency. Run an asset share with that number and you'll see some significant change in the underlying profitability.

The relationship with the M Group has led to success and growth for Security Life. It hasn't been without its strains. Demands are put upon your organization the minute you open your doors and allow your dealers, your producers, and your customers to come in and talk to you about their needs, desires, and wishes. You have to be willing to respond to them in a positive fashion.

At Security Life things are very hectic because we deal in competitive, sophisticated markets. If you think you can create a producer group that has its own company and do it solely with a competitive product and a piece of the action, the tail end, you may be in for a surprise. You must be willing to say to your producer, bring us your ideas, your concerns, your problems, and we will work with you in the creation of solutions. You must work not only in terms of the administration of inforce policies but also in terms of creating sophisticated sales proposals. Get involved with the need to provide rapid access to corporate data so that your agencies can prepare specialized reports for their clients.

There's a book out today called, Winning Back Your Market, by Jagdish N. Sheph. Mr. Sheph talks about many different industries and companies and how they're struggling with the changing economic environment. He concludes that you can pick a good strategy on paper, but you've got to make it work. This is where Security Life sees its future in the M Group.

First, you've got to be consistent. You can't help one agent on a case and then ignore another one. You have to be open to all. Being consistent doesn't mean you have to be rigid. You never compromise your principles, but you have to apply them differently in different situations.

Second, you should strive for win-win situations. A producer-owned reinsurance company receiving ultimate profit due to the experience on their business (and that also results in improved profits on your piece of the business) is a win-win situation.

Third, you've got to test market your ideas. Security Life and Pacific Mutual spend a great deal of time with several of the members of the M Group in the development of new products. We may have six or seven meetings before the product is actually finished and is put to them for specific cases that they are dealing with. Will this work? What are the problems? What are the concerns? If you can keep that type of a relationship with your agency force, you're going to eliminate bringing out those products that will never sell.

Fourth, you have to create an entrepreneurial atmosphere. You have to create an open environment. You have to be willing to give plenty of rope to the people you deal with so that they can move forward in the directions that best suit their business.

Fifth, you must monitor the changing environment. Things we've done so far in the development of the M Group and its relationship with Security Life may not work in a new environment.

I don't want to give the impression that the only producers of Security Life of Denver are the members of the M Group. Last year they produced about 70 percent of Security Life's business, which means we have a fairly significant set of producers that are not members of that organization. We cannot afford to ignore those individuals. This is critical for some of the larger companies that may be looking at producer-owned reinsurers. You cannot work with those individuals exclusively. You have to create a balance with the other producers in your organization.

MR. MILLER: You can have a gorgeous looking producers reinsurance arrangement, but it's not going to go unless your company has the ability to produce the interestingly designed and competitive products that are absolutely necessary for success in the types of markets where the agents operate. Your leading agents, some of whom are also leading agents of other companies, are very important to you. However, most of us have many other agents and pieces of our distribution organization that we have to pay attention to as well.

What you're really proposing is that we take money that we have been paying out to policyowners in their dividends and give it to the agents instead. Why in the world should we do that?

MR. SCHWARTZ: I don't believe there's really a distinction today between dividends and interest-sensitive products or high yield products or universal life. The profit margins in newly developed products are much slimmer than they have been in the past. In addition the persistency of the business that is generated by this approach will provide a far greater level of profit than could be passed down through dividends to the policyholder and still provide the agent with a significant benefit. The old premises are in error in today's marketplace.

MR. MILLER: You have to convince yourself that it is indeed a win-win situation, and better persistency can indeed generate a lot more dollars down the pike.

MR. CHARLES G. BENTZIN: I'm Charles Bentzin, consulting actuary in Phoenix, Arizona, and it's been our pleasure to work with Mr. Schwartz in the development of his companies and also the other Executive Life companies.

It's important to realize that even though we were involved in organizing the companies, this is merely a technique. The success of the technique is directly related to the commitment of the person or persons who are responsible for it. We've talked with people who've felt that forming a producer-owned reinsurance company is somehow a panacea. It is not. It must be worked at just like any other technique.

We've been involved in agent-owned and captive reinsurance companies for twenty-five years. The common denominator among the successful ones is simply that someone believed in them and was willing to work at them. Under the traditional method which has a high first-year commission and a low renewal commission, we have a system which is inherently unsound. It's a fundamental rule that any compensation system should encourage the compensated person to do what you want him to do. In the case of an agent, it means writing business that has low mortality and low lapses. The present system is unsound because it pays the good agent too little, and the poor agent too much. A properly designed agent-owned or producer-owned reinsurance company can overcome this and properly reflect the kind of production that you would like to get.

We are participating in a company sponsored by a large eastern mutual. The company should be in operation some time this year.

There are two major types of producer-owned captive reinsurance companies as far as organization is concerned. One of them is referred to as a simple company, which has a reasonably simple structure. Another alternative is an exotic company, or a multiclass company. There are various advantages in both but these are only examples of some of many alternatives that are available in the design of an efficient and successful producer-owned reinsurance company.

MR. DURLAND: The profit question goes back to looking at what we're doing from a business perspective as opposed to an insurance industry perspective. It's a very common practice within the general business community to price for future market share. You have to take the perspective here as Security Life did. To do this successfully, you have to strive for the production levels that will decrease unit costs, theoretically therefore increasing profits. But to go into this from the premise that the piece of the pie that you can cut up will stay constant will probably pose real problems in justifying what you are doing.

MR. HAROLD G. INGRAHAM, JR.: I am speaking from the vantage point of a company with a somewhat procrustean general agency distribution system whose top agents belong in some cases to M, in some cases to ELAR, in some cases to Hemisphere, and in some cases to others. The company can't afford not to join in because we're seeing an increasing erosion of production from the top agents. They're putting their better business in these reinsurance companies. They bitterly resent having compensation they feel entitled to being siphoned off to the general agent who they perceive does little or nothing for them. By embracing the concept and developing your own reinsurance company, you have the opportunity to reverse this and to capture some of the quality business from agents.

Mr. Schwartz, do the agents in the reinsurance company, when they want a new product, pay for their own software which will support the product? And unlike persistency where each agent's experience stands on its own, you're pooling mortality. I'm curious to know what standard of mortality you're using given that a lot of Executive Life's business is coming from pension takeovers, where underwriting is not always complete. Do you accept business from other companies into the reinsurance company?

Mr. Miller, full coinsurance was the reinsurance arrangement. This suggests that not only are mortality and persistency experience improvements being reflected in the value of the shares but also interest earnings. Now, a philosophical point for a mutual company, which is supposed to be passing on experience benefits to the policyholders, is that although an agent may influence mortality and persistency, they can't directly influence the interest earnings on the business they bring in. Is it really appropriate to have full coinsurance as opposed to say a modified coinsurance agreement? Or, in the case of a mutual company, shouldn't some of those interest earnings be passed on in the form of increased dividends or, in the case of universal life, excess interest credits?

MR. MILLER: I'll respond to the last one because I can do it quickly. Consider the reinsurance on some sort of yearly renewable term basis.

MR. SCHWARTZ: Mortality and persistency are pooled in our companies. We do not isolate each agent's persistency. We have a mechanism within the company that allows us to buy out an agent if we find he has poor persistency. We do not allow him to continue producing business when he falls below certain levels of persistency that we structure into the contract. He signs an agreement allowing us to do that, both on production levels, for which he agrees to a five-year-commitment and to a certain minimum level of persistency.

On the mortality side, it is not entirely accurate that the vast percentage of the business is coming from pension takeovers. There are other takeover products. We have a business takeover product and we have, in effect, a man-on-the-street takeover product. These are providing some significant amounts of business. But the vast majority of the premium that is being generated is not takeover business. Sixty percent of the business is new, underwritten business and we're using the same mortality assumptions that Executive Life uses. They charge us expenses the same as they charge themselves and everything is done internally at arms-length.

As to investment results, I agree with you fully. The investment results overall on the portfolio of Executive Life have been good under Fred Carr's tutelage, and he invests our money also.

MR. DURLAND: Regarding software, Security Life will not develop a product exclusively for the M Group. Any product that's developed is available to our entire field force. Therefore, we maintain a proposal system and all software. To the degree that specific marketing techniques may require additional work that's the responsibility of the M Group.

MR. SCHWARTZ: It works pretty much the same way at Executive Life. Any software that's developed that will be distributed to all of the marketing groups or all of the people that sell Executive Life's products is owned by Executive Life. There have been times when a particular marketing group will develop a marketing concept, product, or software which will be exclusive to that particular marketing group for a time. Then it will be released. I just recently developed one and introduced it last week.

MR. DURLAND: You asked about the persistency and mortality. The M Group employees its own actuary, tax counsel, and general counsel, and we open up everything we do to them.

Your third question had to do with other companies' business going to reinsurance companies. We opened up to Pacific Mutual in 1983. As is currently written it would be theoretically possible to admit a third company, but not without the cooperation of the companies. Security Life started out with a YRT arrangement, as well as excess investment sharing. It has been converted to full mod-co for exactly the reasons you are talking about. The investment is such a critical part of the products today that a mod-co is really the only way to approach it.

MR. LORNE CAMPBELL: I work for an independent entrepreneurial agency. One of my functions is the review and design of products in reinsurance relationships for my agency. We are able to market tailormade products and can enter into new arrangements with a complete understanding of the consequences. We are also the potential clients for the insurer and can virtually guarantee significant business without any test marketing, but only if the right product and relationship is provided. In addition, we have been able to achieve 95 percent persistency over the years. By the way, my agency does own an off-shore company and is a significant shareholder in one of the agent reinsurance organizations. We also have a more powerful in-house proposal system than most insurers.

MR. MILLER: Mr. Durland, back on the question of investment earnings, you say you have to use mod-co. Would you feel that way in a mutual company environment in the context of the question raised?

MR. DURLAND: Having never been exposed to the mutual philosophy, it's hard for me to discuss that. If the quality of the business is better and the long-term profits are better, profit should be shared by all the parties. In a mutual company that would mean part being shared through increased dividends.

MR. MILLER: Despite the attractiveness of that point of view, let's leave the interest margin for our policyowners. It is possible that we are putting ourselves at a disadvantage in terms of the perceived attractiveness of the reinsurance arrangement to the agents versus an arrangement where some of the projected profit potential does involve interest.

One more consideration that strongly pushes you even further towards the concept that the company has to be an independent entity really run by the agents is that for New York companies, there can be 213 questions involved if the company is not perceived as being truly independent. In other words, this could be some fancy way to evade the 213 limits on maximum compensation.

MR. PAUL T. BOURDEAU: Mr. Schwartz, do you sell single premium deferred annuity (SPDA) and single premium life in your company?

MR. SCHWARTZ: We do not reinsurance SPDAs. We do reinsure single-premium life. The annuities are too intensive with interest earnings providing the profit against the surplus strain.

MR. BOURDEAU: We've been so carried away with the product revolution that we're facing a distribution revolution. What's an eastern mutual paying as far as acquisition expense on new business, when you take total acquisition expense including recruiting and training of agents per dollar of premium?

MR. MILLER: Too much.

MR. BOURDEAU: I would guess that most companies with career agency forces are probably paying 180-200 percent. And Mr. Schwartz's organization is probably getting close to 100 percent. It's a very efficient way for a company to sell.

MR. SCHWARTZ: Executive doesn't pay out more than one hundred cents on the dollar. So, there is no surplus strain from the commission aspect of the distribution. And the distribution system only relates to commissions. We are the agency department. We create the product.

MR. MILLER: I am not saying that we think the answer is to abandon the agency system. Our real challenge is to make that system more productive.

MR. SCHWARTZ: Should all you "large company eastern mutuals" determine that you should go into this method of distribution? Do you have a group of people in your agency force who are independent and entrepreneurial enough to sit down and say this is my deal and I'm putting it together?

MR. INGRAHAM: The agents that came in this initially have got their own executive committee and what I see emerging here is that they're trying to run it by an executive committee rather than have one strong leader. And I have serious reservations about the feasibility of that. They'll come up with one strong individual and give him the kind of incentives that you would give him. I don't see any other way to make it successful.

MR. SCHWARTZ: There is one other approach. I copied an article that appeared in the CLU Journal on agent-owned reinsurance companies, the new breed of compensation. It will give you an understanding about how both we and Integrated Resources operate. Their's is a little bit different. Each individual is "a big hitter," and he has his own isolated block of business within that company.

That creates another problem where a particular agent is looking to capitalize on his or her own block of business as it relates to nonpooled mortality and nonpooled everything. Changes in tax consequences might blow out a block of retired lives reserved business. So everyone feels they really have their own company. We've chosen, for obvious reasons, to pool everything and to diversify our risk.

MR. MARVIN D. FINEMAN: Mr. Miller, for a mutual company, you might want to consider replacing the three factor dividend formula with a four factor formula, the fourth factor being profits from agent reinsured business.