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DIRECT RESPONSE MARKETING - LIFE AND HEALTH INSURANCE

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HARRY PLOSS: It is fashionable to be in direct response marketing. Many companies have entered the market, perhaps because they see higher returns in the direct response market than in their traditional agency markets. You need a business plan and a direction to make money in the direct response field today, because it has become quite competitive. Without a direction, you will flounder and not make the profits that you vaguely hoped for initially.

A wholesale strategy and a retail strategy work. The retail companies develop and maintain large customer lists. Some were fortunate enough to have obtained these lists from their parent corporation, which was in a totally different business, while others developed them from soliciting the general public which has responded to newspaper or television ads. You can also buy the names through list brokers. Once the company has a large list of potential customers, it will begin to sort out which are the profitable prospects.

A retail company's most profitable customers are those who have already bought from them. It is usually very profitable to resolicit these customers to buy new coverages or to increase their existing coverages. Policyholder service should be conducted in as positive a manner as

possible. This is one of the best opportunities to close a low pressure sale. Excellent Watts number service can greatly enhance these repeat sales, and is often supervised by marketing.

Certain guaranteed issue products can be sold after you pay a claim. Can you think of a more positive time when people realize they need insurance?

New customers are more likely to come from people who have a similar profile to existing customers. One statistical way to achieve this is through demographic enhancement of lists. If you have a prospect list, you can go to a vendor that provides census track information, and through the person's address, you are able to determine roughly their age, marital status, income and lifestyle. By adding this data after you do a multiple-regression analysis, you can find the most likely prospects.

The best half of a list can often get a response rate three times that of the bottom half. This means that the top half of the list has a 50 percent better response rate than the list as a whole. Often, you will lose money on the whole list, but the top half, or quarter will achieve profits that you could not achieve otherwise.

While information is getting cheaper, and there are more brokers selling information, printing and postage are getting more expensive. Information-based strategies to find good customers are becoming more competitive. Today, the customer base is a tangible hard asset that is often rented and occasionally sold. Mailing-list brokerage is a major business. Lists rent for $30,000 and up for a single mailing. The owners of lists frequently set profit goals of $1,000 per 1,000 names and up.

Companies have set up security systems to guard their customer lists by adding extra control names and taking action against anyone who solicits these artificial names.

Retailers do not pay heavy list commissions for endorsements, but can get some of the benefits of endorsed marketing. You've seen celebrity TV ads, fictitious affinity groups, and sometimes whole companies formed to create greater response rates at a reasonable extra cost.

Competing solicitations can wear out a list. But, if you can run complimentary solicitations, you can exercise and enhance the list and get your customers used to buying a variety of products.

An entirely different strategy than owning names is in the wholesale strategy, where you go out and develop relationships with other organizations. You specialize in increasing the profits of an organization by selling and servicing an insurance product to the endorsing organization's customer/membership lists. Higher response rates are achieved by the relationship endorsement as well as the higher list quality.

Wholesale distribution includes several of the nontraditional marketing channels: payroll deduction, credit-related insurance, and association group. The penetration, or response rate, increases with personal contact. Endorsed direct mail gets a 1 to 5 percent response. Outgoing telephone typically gets a 3 to 15 percent response, and face-to-face solicitation, can get a 30 to 90 percent response. Since expense is also increased with personal involvement, profit margins may not correlate with response rates. For small lists, a high penetration method is the only way to achieve a minimum premium goal, so you will have to go to one of the more expensive solicitation methods.

The wholesale company sells first to the organization, and then to the membership. The first process is often the more difficult one and is often the reason that you need new products, or some other way to distinguish between you and your competitors.

The organization sales process typically takes three meetings to close. The first meeting is information gathering: the size of the customer base, their product needs, experience with other insurers, new opportunities, and the organization's other concerns. The second meeting presents a marketing and financial proposal for a mutually profitable relationship and discusses how this relationship should be consummated. The list owner is often more interested in totally utilizing their list assets, than the specific details of the product. The third meeting is in a board room with the top decision-makers to close the sale and begin the next step, which is to develop an administrative relationship and solicit the new prospects. Both organizations are learning to communicate with each other. Scheduled dates are often delayed, and compromises are made on marketing copy and other customer details. The wholesaler needs to be flexible and make certain exceptions for each customer.

A direct mail solicitation of five thousand to two million pieces is dropped. The response rate gives the first indication of the profitability of the relationship. For the large list, often you will test a certain segment before you do a massive rollout and commit big capital. A one-year mailing schedule is developed to sell the best products at the best available times. Solicitation stuffers in the organization's regular mailers are negotiated. Since they result in quite low acquisition costs, higher commissions can be paid.

Outgoing telephone sales can be made to small high quality lists, in order to generate higher sales volumes. This is recommended where a direct mail campaign would not generate a high enough volume, or otherwise be economical, and you need immediate product feedback. With the telephone, you can put together an initial script or call guide, and see what your customer response is. Also, you can see what kinds of questions you are getting, and, perhaps, modify your product or offer after calling for about two hundred hours.

Generally, life and health insurance cannot be sold without a signed application. For guaranteed issue products, this is a significant legal restriction which makes insurance a cumbersome two step sale because you must make your outgoing call, then get your application back, if

you're lucky. Generally, add-ons are not used by wholesalers because it's not their own customer lists, and they would have to pay essentially the same commissions as they do for the initial solicitation. Segmentation of data to improve response is generally not available, but also it is not as economically necessary, because mailing costs are not as great a percentage of the premium dollar as they are for the retailer. Sometimes, you can solicit the active customer file twice instead of soliciting the whole file, and this will create greater profits. You do have some flexibility with segmentation.

After the list, the next most important things are products and what you are offering. The product only partially defines the offer. For example, an offer to sell a product at $30 a quarter had a very poor response rate compared to a product with $10 a month. Apparent price and value is often more important than actual demonstrations in predicting consumer acceptance, and subtle things like this should not be overlooked.

The function of the package is to motivate people to open the envelope and read the offer. The products that sell in direct marketing tend to be simple and offer supplementary coverage. The most famous ones are term life, hospital indemnity and accidental death. In the mortgage market, disability and unemployment are popular because they tie in with the needs of people who are paying their mortgage. For older ages, graded benefit life, whole life and Medicare supplements are big sellers. A good add-on product is whole life sold just before one's birthday - "buy now and save age."

Other products have been tried, such as cancer, victim of crime, accident annuity, umbrella liability, and between-jobs major medical. New products can be quickly copied. Generally, the marketing risks are greater than the claim risk.

Because of the rising costs of the traditional sale, several companies are trying to sell interest-sensitive products through direct response methods. Payroll deduction has had notable successes, and there are some successes through telephones. There are mutual funds that have had enormous success selling through media, and through the telephone. They have achieved many $6,000 average accounts this way. So, it can be achieved if you are a low cost producer, and you are able to appeal to the sophisticated market.

Facilitating impulse buying is also an important aspect of product design. You use simple applications. Often you have large common carrier benefits or other benefits that can be given away fairly inexpensively. Low price and convenient billing also facilitate impulse sales. Impulse sales are hard to make once the customer must pay $10 or $20 a month.

Fortunately, some sales are based on need. Retail insurers typically need $2 a month per policy to pay for their marketing and administrative costs, so they can often afford to sell the policy for $10 a month and have a 70 percent loss ratio. On the other hand, a wholesale insurer pays commissions and can afford perhaps a 45 percent loss ratio on a $1 per month certificate, if they have some kind of group billing. Either company would lose money if they tried to sell

the product that works for the other.

It is important to develop and test the package so that people open it and improve your response rate. One method is to copy an old standby package of your successful competitor as your first control offer. You can then compare, using an A/B split, to find which package is more successful for your market. Once you become more sophisticated, you may be able to test four factors at a time, using a test design that perhaps uses five calls instead of eight calls, that you need with four two-way splits.

There are many statistical tests you can use to improve your package design. This is more critical for a retailer, which perhaps will spend 20 to 30 percent in marketing costs, as opposed to a wholesaler, which has a higher quality list but also pays commissions.

In conclusion, the methods of prospecting, selling, and servicing customers using computers, media, telephone, and mail are facilitating the growth of direct marketing, both retail and wholesale. Retail lends itself to effective theoretical strategies that were once impossible to implement. Wholesale strategies are affected by the personal, two-level sale, and a lack of uniformity.

MS. ROBERTA CANFIELD: My company, Beneficial Standard Life, has been in direct marketing for quite some time, selling mostly through third party endorsed lists. If we were a new company, we would have to think about where the markets are and who we are going to sell to.

There are several different paths which companies have used. Perhaps the most ideal is a large endorsed list with thorough demographic information which comes from your parent company. A company such as Wards, Allstate, or J.C. Penney has a ready-made market and much data. They can segment in great detail and trace their experience back to exactly who they solicited, when, why, what happened, and how best this can be used in future solicitations.

Another approach is to go into the broad market, selling unendorsed copy platforms. You can get demographic information by either matching to census data or purchasing compiled lists. These usually get much of their information from the Motor Vehicle files, which give you age and residence information. You can add onto that by creating an affinity group or perhaps by adding benefits outside of insurance to get a real group, as in the American Association of Retired Persons (AARP), or just implying some group by the name that you use. Another way is to go in with a specific type of product which defines its own market. Mortgage insurance seems to do this. Juvenile insurance is another, where you are selling insurance to kids, and you would want to target in on lists of other products which were designed for the same market.

A different approach is to look for people who respond to direct mail, irrespective of what their characteristics are. This would be the so-called hotline lists approach. They come from a lot of different sources, such as magazine sales or different types of merchandise

sales. These are people that have used the mail or the telephone to buy something that has nothing to do with insurance. These lists can be purchased, and used to build up your own policyholder base. The key here is in getting to those people quickly. Once they've made a decision to do something through the mail, if you can get to them within a few weeks, they might buy your product too. However, if it's a month or two down the road, there is no relationship anymore.

Beneficial goes through third party markets, where we develop a relationship with either a retail store, or an oil company, which has billing facilities through a credit card. Banks and Savings and Loans can sometimes fit into this category as well. In such a case, you are going to be paying a commission composed of two components to this third party. First, there is some fee for the use of their list, which may be a list fee or a percent of premium. Then, there is some compensation for assisting you in the administration. They are going to be doing the billing and collecting. The advantage of going with this approach is that the endorsement that you can put into the copy is very strong, and it has a great deal of meaning to the prospective policyholders. The customers have a close relationship with the retail store because they have the credit card, and they are in contact with it on a moderately frequent basis.

You get very good persistency with this type of business. Automatic billing is the key. People have to take an active step to cancel their policy. If they do nothing, they will continue to be billed. Further, since the retail outfit is doing the billing, you can often negotiate insert mailings saving postage. You will get a lower response rate, but you usually come out ahead over a direct mail solicitation.

Morbidity is usually lower with these types of lists. With the same product for a direct bill client and similar demographics, credit card billing gives you 5, 10, and sometimes even 15 percent lower morbidity. Consistently this is tied to the persistency and perhaps to the conservatism of the initial list. The same people that want a credit card with a department store or oil company may be less likely to have claims.

There are limitations, however. When you do a solicitation where you are asking the people to sign an authorization to charge their credit card, it does inhibit response. People are actually signing a permission to bill them, and therefore, they're not going to do it, if they are one of those people looking for 30 days of free insurance.

Many retail stores do not have anything in the way of demographic information either. It is possible to add demographic information to such a list by paying a software company to match the list to their compiled files. This is not always cost justified. In addition, some retail stores are very small. They want to get into this business and make a profit by coming up with this sort of arrangement, but they are just not worth the expense of significant segmentation.

Retail stores are also very image conscious, and this can inhibit what you can sell to them. If the copy seems too much like junk mail, they may not want you to send it out, even though you can prove that it sells. Also, this is a very competitive market, so you've got to convince each client that they should market through you.

Beneficial has done some work on endorsed lists with noncredit card billing facilities. In this case, your compensation to the third party normally should be less than if they were doing the billing for you. We found that unless the third party has something extra to give, it's very difficult to make a profit. The primary thing is to share the risk in one way or another. Going in on a quota-share reinsurance arrangement is great if the client list is large enough, and the third party has an affiliated insurance company. Then there is no commission to be paid. You are just in business together.

Another thing that the direct bill third party can provide is demographic information on the files. They can provide you access to the hottest of the hotlines. In other words, you can get to them within a week to ten days. And as a minimum, they have to share the risk to the extent that their compensation is tied in some way to the results that you get. If it's a list fee, it ought to be graded somehow by the response that you get. If a third party is just being paid money, and the company is taking all the marketing risks and paying compensation to the third party, it's very difficult to make the arrangement work.

In my company, we do have a lot of different clients which makes it difficult to know what products you should spend time developing. You have to have a portfolio of products to meet several different situations.

The biggest part of your pricing job in direct mail is determining the acquisition cost. That's where most of the risk is. The acquisition cost, unlike agent sold business, isn't tied directly to the business that you're selling. How much premium you get in does not give you any handle on how much you spent. Acquisition costs trace through the process of marketing and include such things as developing copy platforms, telephone scripts, or television ads. Then there is the delivery cost of buying air time, printing, mailing, or telephoning. For the people that respond and meet your underwriting requirements (even if as simple as an age range), you incur an issue cost. Finally you find out how many people are actually going to pay premiums. Acquisition costs occur well before you get that first dollar of premium, and although overall there is a relationship, they aren't tied directly.

How do you profit test for this? How can you design a product that's going to suit all the variations?

Recognize that product development has to be considered in two stages. There is developing the product that you're going to file with the states and have available for marketing, and there is continuing product development that goes on as you market. You have to decide to test what different benefits you're going to offer, how you are going

to structure the advertising copy and what needs and wants of the consumers you are going to play-on, in order to get them to buy. Are you going to package it with additional benefit riders upfront, or are you going to sell those later as add-on solicitations? These are product development decisions. They affect what is happening with your average premium, your response rate, and thus, your acquisition costs. You continue with that process well after the product has been filed with the states and is available for sale.

In initially pricing that product, you have to look at possible scenarios of the basic assumptions. Acquisition costs are normally considered as a cost per paid policy. I compress the acquisition costs down to one number or a range of numbers. Obviously, there can be a range of persistency values, and third party compensation varies quite a bit by client. Fortunately, these things are somewhat tied together. The simple case of a direct bill client normally has a high response, and thus a lower acquisition cost per paid policy. But to offset that, you have worse persistency; thus you're going to get less premium overall. You also have lower third party compensation. These things move together, but you still have to price for a range of values.

One thing that is worth a lot of time in pricing is the morbidity experience. Ideally, you're going to set premiums so that you don't care what face amounts, elimination periods, or daily benefit amounts they sell. This is, of course, impossible because another requirement of direct marketing is very simple premium structures. You have to cover a broad range of ages with one premium rate, so you cannot possibly be immune to everything. You really have to go into detail in understanding what the risks are. Statutory minimum loss ratio requirements are very important in this stage, placing constraints on what you can afford to sell. Since most of your risk is with the marketing, you want as much of the premium as possible to be spent on marketing. That is where you are taking the risks.

In my company, we have turned the continuing part of product development over to the marketing people. To aid them in their task, the actuarial department has developed a solicitation model, an idealized and simplified projection of the monthly cash flow for ten years. You have to get down to a monthly basis on this type of business. Your persistency varies very much by monthly duration. They run the model first, before they solicit to plot out what they want to test. They use projected values for response rates, issue rates, conversion rates, printing and postage costs, average monthly premium, and third party compensation. Then they use assumptions, which have come from the actuarial department, for things like persistency and various maintenance expenses; both of which will vary by product in some cases and by client. Finally, we must consider morbidity. For use in the model, we simplify the morbidity to a single loss ratio. That is not what happens in real life, but for the purposes of evaluating solicitations, we found that to be adequate. The morbidity does vary by product and by client, so it reflects this and has been calculated to take into account the expected pattern by duration. The model does ignore such things as reserves or necessary capital surplus; those things need to be considered in product testing and product design, but they really don't have much impact at the solicitation level.

The model can be run at a lot of different levels. We can get down to an individual segment of two thousand pieces, or ten million pieces with subtotals in between. You can also combine multiple mailings over time. Basically, the output from the model is discounted values of the cash flow at a given interest assumption, a calculated percent of premium profit at that interest assumption, and an internal rate of return, which is based on the cash flow. Also, there are certain other marketing guidelines; a cost per paid policy, and a total annualized renewable premium ratio, which is just the total annualized premium sold divided by the marketing cost. Again, all these numbers are on a segment basis as well as in total.

The model also produces target values for response rates, the mailing cost per thousand, or the average premium necessary to meet our profit objectives.

Using the results of that model, the marketing staff can decide whether to test something based on the history with clients, the experience that the individual people have had, and what they think will be the results. Also, the model is used in evaluating what has happened or what copy platform or benefit offer won. You cannot just go by response rate. You have to bring all the pieces together, because it's the total profit that we want, not just more policies issued with perhaps a lower average premium.

The actuarial department's role in this ongoing marketing effort consists of being a consultant to interpreting the results of this model and helping when they want to do something tricky. We also update the assumptions regularly - primarily the morbidity, persistency, and expense assumptions. The basic form of the output is appropriate for tracking the results on an overall level. It provides continuing feedback for new product development and ongoing marketing success.

MR. EDWARD MOHORIC: When the term direct mail or direct response is mentioned, think first of the old standby, hospital indemnity. This is the product that most frequently comes to my mailbox. The marketers tell us January and February are high response months, so that's when most of the solicitations are done. During this year, I received six different offers to purchase hospital indemnity products from a number of different insurance companies.

I also think of term life insurance, for which I received two offers during January and February, and of accidental death insurance, for which I received only one offer this year, but I think that's a statistical aberration based on my small sample size.

Hospital indemnity, accidental death, and term life, along with the old-age products of Medicare supplement and graded death benefit whole life, have been the mainstays over the past several years of the direct response industry.

As mass marketing competition has intensified, and more companies have moved into the arena, we have seen these products solicited repeatedly. In a number of instances, we've seen the response rates drop, sometimes dramatically, as the same name lists are used again and

again; the lists wear out. The lapse rates have frequently increased which causes claims to increase.

Now, why has the same product been used? Three reasons are: (1) it has worked well before; (2) the product is simple; and (3) the consumer wants it.

As response rates declined on a list or merely in order to boost the profitability of a product, there has been a trend toward solicitations for increased benefits with the same products. The profit calculation in this is simple. If you've defined your acquisition costs as a percent of premium, then you can meet this acquisition cost goal by either increasing your response rate or increasing the premium. If increasing your response rate seems difficult to do, increasing the premium is merely a function of increasing the benefit. On a recent hospital solicitation, the benefit reached the $100 a day level, twice that for intensive care. Since this plan is presumably coupled with a major medical plan owned by or provided to the insured, an additional $100 or $200 a day is a lot of ancillary benefits. I have seen little experience analysis which has been segmented by amount, but one company's experience has shown that the higher coverage amount does have a higher claim cost per dollar of benefit.

Similarly, solicitations for direct mail term insurance have reached $150,000. Do these amounts cause antiselection concern or is the short form underwriting good enough to prevent masssive antiselection?

There are advantages to increasing the benefit levels of products, but we need to consider expanding the product alternatives that we are soliciting on a direct response basis.

There are many insurance products that either have not been adapted to a massive solicitation medium or have not been used frequently. Some products have been avoided because they are not perceived to be simple, such as universal life, and might not go over well because they can't be presented so that the consumer can understand them. But, if you have a list that is properly segmented, I see no reason why a well designed universal life marketing campaign wouldn't work. Other products have been avoided because of the so-called risk involved, for example, disability income. Yet, to stay viable in the marketplace, companies will have to take, and have been taking, more risks.

In determining what products you want to sell in a direct response campaign, here are three considerations:

1. Does the product meet a need?

2. Is the product right for the group to which it's being solicited?

3. Does the product fit logically into your company's portfolio?

One reason that hospital indemnity has been so successful over the years is that it has been meeting a perceived need. As actuaries, we need to design other products that the consumer wants - an IRA annuity, for instance.

Is the product right for the group? My former employer was a company which at the time solicited to the AARP and sold a lot of medicare supplement insurance. The target population was primarily an over sixty-five market. The medicare supplement product is totally an over age sixty-five product. That was a perfect fit and a great example of a product being right for a certain group.

A more common approach is for a company to take a product, like a five year age-banded term, and sell it to several of their lists of names, ranging from alumni groups, to bank card holders, to the Boy Scouts. Term products are easy to design and rearrange. If you're soliciting to an alumni group, rather than a five year age-banded term, wouldn't it make more sense to sell term life to the parent for the time period until the child turns age 18. Your marketing thrust could be: If you were to die now will your child be able to attend the college of his choice? If you're soliciting bank card holders, does the individual have a mortgage or an IRA with the bank? You could design a decreasing term product to fit around either of these. If you're soliciting to a department store list, where the card holders are predominantly female, adding on a maternity benefit or some other benefit that appeals to females would be a big plus for your hospital indemnity product. In many instances, a product can be designed that augments the marketing thrust desired for a group.

Does the product fit into your portfolio? A new product can be designed to be a logical extension of a current portfolio. If you have had good response selling hospital indemnity, you could design a product that would extend your current focus. For instance, you have hospital indemnity, but what if you need surgery? You could design a surgical schedule product to be used as an add-on sale. You could even include in-hospital doctor visits. Or, if you've been soliciting life insurance, a disability income plan would be a logical add-on product or could be solicited jointly on an either/or basis in future campaigns.

The direct response market place is maturing. There are more companies in the field than there were ten years or even five years ago. There is much more sophisticated segmentation being done, and lists aren't being used as randomly as before. There will continue to be a large marketplace for direct response sales with a properly designed program. However, a company cannot go blindly into direct response anymore and meet profit objectives. If you have good lists, a good marketing force, and proper segmentation, a company can develop an innovative product with a perceived need. You can capture a market niche, and you can continue to generate the responses necessary to make direct response viable.

MR. DOUGLAS ANDREWS: When you have a list and a product which you think are going to work but instead fail miserably, and they continue to fail, do you have any way of getting out or are you locked in? How do you try to recoup your losses in such a situation?

MS. CANFIELD: If you can figure out why it failed, you may be able to come up with something quite different. We signed up a client to do a test mailing and did not properly investigate the characteristics of their lists. One mailing was abysmal, and we found out that they were primarily people in their early twenties. A high portion of them were still living at home with parents and didn't want insurance. We just severed the relationship. If you make a mistake, you can get out of it, but if you do see a way to come in with something else that you already have, you should exploit that.

MR. ANDREWS: Did you remain on the risk for the policyholders?

MS. CANFIELD: Yes. We didn't have any problem with that; the main problem was that people just didn't respond. The few that did should be fine.

MR. ANDREWS: Wouldn't it make more sense to cancel the coverage?

MS. CANFIELD: If you're talking about a group policy, you could cancel the policy if you felt there was a problem with morbidity. The big risk is the marketing risk, the response rate and are there enough of the right people in the lists so that you can make a profit?

MR. SHUMRAK: These days when you are making such supreme efforts in interest-sensitive products, with all the months, expenses, and human resources to develop the product, if that were to fail, it would be fairly catastrophic. In direct response there's a cliche that has merit: the testing is the life blood of the processing.

You constantly experiment with product prototypes and realize that in some markets, out of ten ideas for products and ten products that you have developed in some sense, maybe only a few might succeed, or a certain variation on a theme might succeed. This is a real contrast to the agency distribution system where if you had those odds it would be quite a problem.

MR. RICHARD PITTS: In developing the product not only do you want to concern yourselves in the application with a few short form questions, but also with a lot of internal limits, with preexisting clauses, and with your contestable period. Do not give these away. There's some pressure on the east cost to do this but all of our claim studies indicate that you do not want to.

Ms. Canfield, do you use your model for acquisition cost deferral? Do you do it for a ten-year period?

MS. CANFIELD: We don't use the model to determine our GAAP earnings in any way. But, we do defer printing, and postage and some of the costs in writing the package and tracking the solicitation. There are other expenses which some companies defer on top of that, but we do not. We are currently amortizing them over ten years on a work sheet method , using current persistency assumptions which vary to the client group level but not to the client level.

MR. PLOSS: Liberalizing benefits is very dangerous, if you have not done market research to see what the customer perceives the value to be. For example, on medicare supplement some products pay 20 percent of what is not covered by medicare and some pay 100 percent. The difference in cost can be enormous. Unless the customer perceives the difference, you are better off with the cheaper product. There are ways of testing this through either phone interviews, focus groups, or small sample mailings. We have seen cases where the lower priced product actually got a worse response rate than the product which we all knew was more consumer oriented. There are surprises, and that's the importance of testing.

It's typical to defer acquisition expenses for ten years with an actuarial schedule, unless it's similar to a wholesale type distribution system where the whole block could be cancelled. Then you have to be considerably more conservative, perhaps writing it off over a year or two.

MR. MOHORIC: You really should fight hard against the pressure to reduce the preexisting period. One of the problems with direct mail is that there is such a potential for antiselection on the part of the insured. If you're talking about a benefit, such as the medicare supplement paying what medicare doesn't pay, or some sort of dental benefit that is under the control of the insured, you need preexisting and limited underwriting to control it. Otherwise, it can become impossible to price.

MR. PITTS: I agree with you. Also, not only do the incontestable period and preexisting period help you control antiselection, but they can help maintain the claim costs on what are not antiselection claims. We found it particularly helpful in our block where there are increasing numbers of cancer and violent crime claims, which have very low benefits. They were definitely not antiselection claims, but if you have an adequate contestable period, you may be able to deny some of the claims, and assist your claim cost.

MR. BRIAN GILLESPIE: Presumably in direct marketing, the mailing of the product is serving to replace the commission that would otherwise be paid to an agent. If you were to equate the marketing cost of the organization to either the earned premium or the written premium, what would be the normal goal? Also, what sort of minimum loss ratios are typically sought?

MR. PLOSS: You have to start with a model like Ms. Canfield's to work out what loss ratios, acquisition costs, and other things you can put in and make a profit. You can build a simple model with Lotus One, Two, Three. Typically, if it's a very inexpensive product like an Accidental Death and Dismemberment (AD&D), you're going to have to have a low loss ratio, which is typically 35 percent. This is below the guidelines of various states, and you do run into problems. If the premium is high, you can afford a higher loss ratio, depending on what your expense structure is.

There is really no one set rule. One thing about direct marketing and mailing is that the costs are paid whether there is any business produced or not, whereas an agent only gets his commission if he has actually made a sale. It is hoped that you are not selling the same products the agent could sell profitably. Otherwise you'll generate animosity between the direct marketing arm and the agency arm.

It's dangerous to compare agency to direct mail, and say that there are certain benchmarks in terms of acquisition costs. You should run through your model and see what would be an acceptable budget. For people who need rules of thumb, this model is better than a rule of thumb. You can then work out for each product (perhaps with weighted-age distributions) what marketing expense you can pay as a proportion of your total annualized premium sales.

MR. GILLESPIE: You suggested a benchmark for accidental death plans, can you suggest a similar benchmark for the Hospital Income Protection plans, or for the term life or paid-up benefit life?

MR. PLOSS: HIP is run from low numbers up to 70 and 75 percent, so you really have to work it through and see who you are soliciting. For AD&D my benchmark was for the plans that were $2 to $5 a month. Now, there are people out with accidental hospitalization, and they've added all these things together so that they are running it at $10 a month, and they can afford much higher loss ratios.

MR. JOSEPH MORAN: Mr. Mohoric commented on marketing permanent life insurance coverage. He specifically referred to universal life; there must be actual experiences on which information is available for other types of life insurance with permanent features. What are the patterns of comparative return rates on direct mailing for a permanent life insurance versus term life. Will you comment on the regulatory situation concerning permanent insurance values on such products.

MR. MOHORIC: In terms of the comparative rates of return, it's not just a function of comparing one product to the other. You have to consider who you are selling it to, the type of medium, and the type of kit you've put together. The whole life products, such as universal life, can generate a premium that is higher than your normal direct response premium and you can get away with a much lower response rate and still meet your acquisition costs goals easily.

MR. MORAN: Could you also comment on the regulatory aspect concerning nonforfeiture benefits on direct marketed products? The individual nonforfeiture laws in most states specifically do not apply to group insurance policies. Do the regulators take a position as to the basis on which these benefits should be determined for mass marketed direct response coverage where the group insurance mechanism is used?

MR. MOHORIC: Most companies that sell graded benefit whole life, for small amounts, basically burial insurance, do comply with the nonforfeiture standards. In terms of universal life, I don't know that anyone is trying on a mail basis to comply with the National Association

of Insurance Commissioners (NAIC) model regulations. The only company I can think of that has sold universal life is USAA, which sells to military officers. A couple other companies have tried it, but I don't know if they've been successful.

MR. PLOSS: Before universal life, we used to sell whole life to existing customers just before their birthday. It only got a good response rate because it was existing customers we were selling to.

The legal departments I've talked to have always been very sensitive about group insurance and whether it was really group in some strict sense, or whether companies were trying to get around the valuation laws by using group. They have always taken the position that the industry should follow the individual laws simply out of good faith. We basically should try to be low profile, follow the laws and have lower acquisition costs, or have more control over ourselves.

MR. JAMES LATHAM: We generate about 60 percent of our life premium from universal life, and we will sell about two billion dollars worth. We have an IRA marketed in January, February, and March, and we'll generate about sixty-eight million dollars worth of premiums from that this year.

MR. LES WEBB: Mr. Mohoric, you mentioned disability income, and said that it might be a good market. Our experience in mass marketing disability income in the United Kingdom has been a little short of disastrous, to the extent that whenever response rates have gotten high enough, we found that up to 50 percent of the applications have turned out to be substandard when they're underwritten. By the time you've put loadings or restrictions on the terms, they just don't compete. One broker I know is trying to convince us to do a guaranteed issue long-term disability product, which I'm strenuously resisting at the moment. Would you comment on that aspect of the underwriting problems?

My second question is on IRAs. The equivalent product in the United Kingdom is what we would call an individual pension plan, which is sold extremely successfully by some companies either in national daily newspapers or off of TV-generated leads. In both instances, because of the complexities of the tax situation, it involves a two, three, or even four stage completion process to actually get the sale. Would you envision a similar kind of situation in the US market in generating an IRA?

MR. MOHORIC: To answer your second question first, in many cases it could be done on a one-step basis. It's likely that it would take more steps, because it's a bit more complex than the normal type of product and would be the type of product you would want a telephone hotline or toll-free number for customers questions.

On disability income, I believe underwriting would be a real concern. A couple ways around it would be to have disability income as an aside or in addition to a life insurance benefit. One product designed was

what we called an IRA completion product, which sold life insurance, decreasing term amounts to age sixty, and disability income of two thousand dollars a year to age sixty. We didn't feel that there would be a significant antiselection on that.

If you were selling a disability income product on its own, the antiselection would depend on the amounts.

In stating your experience, was that large amounts or small amounts?

MR. WEBB: They were disability income contracts sold in their own rights, and the client had the option to pick the amount of insurance not exceeding 75 percent of his predisability earnings, less state benefits which are not really significant in the UK. So, it was in relation to salary quite a high level of benefit. It certainly wasn't in the order of two thousand dollars per annum.

MR. MOHORIC: For something like that, it seems like it would be very justifiable to do a good underwriting job, and you could work the cost of the underwriting into the cost of the program. You ought to be able to justify that cost, unless you're saying you're getting almost all substandards, and then it wouldn't be worthwhile.

MR. WEBB: Yes, the problem was that in trying to avoid the cost of medicals, most initial underwriting was done with medical attendance reports, or attendant physician's statements in American terminology. Every other one was coming out positive to the extent that we knew the applications would never be accepted at standard rates.

MR. MOHORIC: If your response rates are high enough, even if you have to cut out a third or a half, it might work. You have to do the profit analysis.

MR. PLOSS: I was wondering if anybody has had any luck with substandard in the direct marketing field? Generally, all the places I've seen reject straight out, and make no attempt to try to explain to the policyholder why substandard would be good for them.

MR. LATHAM: On our sophisticated products, we write substandard; we write the whole gammit. There's no problem with it.

MR. WILLIAM CHIN: Our company has been involved in accidental death products and in unemployment insurance. One problem we've run into is the legal environment with the applicability of the group trust approach in various states. Has anyone done much research in this area?

MR. PLOSS: It's a sensitive issue. I would say that it's dangerous to sell in states in which you're not licensed, especially if you are doing it through a group trust. Various legal departments will take different viewpoints on that. There is always a business risk that you will lose a group trust in a state because of a single case causing that state to withdraw the trust. A possibility is to set up another group trust

in another state. So, if your first group trust falls, you transfer all the business to the other group trust. You are getting into business considerations and other things that the legal profession is not able to discuss and you will basically have to consider all the things that can happen and behave as nicely as you can, not be abusive in any way and just hope for the best.

MR. CHARLES SHERFEY: I've worked with several groups which are completely different from the type of groups we are talking about marketing to today. Primarily, they are associations of physicians which are very successful in selling disability income insurance in large amounts to their members. They have many different levels of insurance needs, and as a result, they may need some supplemental insurance, term life, or hospital income, for example. Doctors have specific insurance needs and often rely on these programs for their basic insurance coverage. This coverage is generally very thoroughly underwritten, although a medical is usually not required. Full application and attending physician's statements are required and waivers are occasionally added to eliminate specific causes of disability. The amounts sold are up to five thousand dollars a month, 80 percent of after-tax income, and that has been very successful.