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INDIVIDUAL LIFE INSURANCE AND ANNUITY PRODUCT DEVELOPMENT

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- o Marketing insurance products through stock brokerage firms, banks and broker-dealers.

MS. ALICE M. NEENAN: Edwin Gold has worked for Continental Insurance, Sales Corporation and First Investment Annuities. In 1977, Ed co-founded Franko, Incorporated. Franko is a full-service wholesaling team that represents a number of life insurance companies for the sale of fixed and variable annuities and single premium life insurance. It works with stockbrokers, broker-dealers, and independent life agents and financial planners. Franko is currently the largest organization of this type and expects to write $1 billion worth of premium in 1988. It has 60 home offices and approximately 30 full-time wholesalers out in the field. We felt that Ed's perspective would be particularly valuable at this meeting since the topic is product development and nontraditional marketing.

MR. EDWIN J. GOLD: I was asked to address this organization on the topic of nontraditional marketing in the marketplace as we know it today. I sat there at my desk and I said, I wonder what this is all about. Then I sat down and started to put a bunch of words on paper to separate the non-traditional salesman from the traditional salesman. If you look at the traditional salesman, it's the life insurance industry, the life insurance salesman; I had to figure that everybody else was nontraditional. What was the difference as to the way they approached the marketplace? I wrote down my words. I probably came down to about six words that expressed the differences between the two and give rise for the need of an organization of our type. Essentially, we talk about death versus life benefits. The traditional salesman, more often than not, is selling the death benefit of life insurance.

The nontraditional salesman is selling the life benefits, an income sometime in the future, an income stream. Protection versus growth. It's more important for the life insurance salesman to protect what his client has and it's more important for the nontraditional salesman to show growth in that portfolio. That's where he comes from. High versus low commission. This is not an indictment of the insurance industry; it's essentially a comment on the fact that the sell of standard type life insurance is a much bigger job. The sell of a single premium deferred annuity and single premium life is not as difficult and the salesman is willing to accept a lower commission. So, we have the nontraditional salesman lining up as somebody who sells life and income benefits, somebody who sells growth, and somebody who's willing to take a lower commission because he's going to sell a higher volume of product.

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Who are these people? It's obvious that the first class of people in this type of organization includes the stock broker. He's an equity-oriented person. He comes from a different life-style. He has a different way of communicating. He has a different way of selling. He sells on the telephone versus selling face to face. The thrift institution and the remote broker-dealer, relatively new phenomena, grew up over the last eight or ten years. Essentially there's a need out there for a broker-dealer to do all of the clearing that might be done by an individual broker-dealer. A person going into the equity business may not want all the paperwork that is entailed in setting up a broker-dealership, so he has sought out a type of institution that could fit his needs. These broker-dealerships are usually in 10, 15, or 18 states, have about 700 or 800 salesmen, and they clear all of the equity sales and do all their mutual fund sales through that broker-dealership. These broker-dealers are nontraditional salesmen, if I can call them that; and it seems as if we had a breakoff in the system both from the stock brokerage community and the insurance industry and formed a financial planning movement. And the financial planner is more oriented toward the income and the growth and the low commission type product than is the traditional life insurance salesman. There are lots of areas of concern dealing with this group of people versus dealing with the traditional life insurance salesman.

The first thing that comes up with nontraditional people is "do diligence." I sometimes refer to it as "do-da diligence" because they simply don't do the job they should do, but it's necessary. In order to get your product into a member firm, into a thrift institution, buy a multistate broker-dealer for it. You have to provide him with a bunch of documents. They're not special documents. They all exist. They're everywhere in existence, but you've got to put them together in a package. And you've got to go to New York. You've got to go to St. Louis. You've got to go to San Francisco. And you have to sit down with the head of this member firm and say, "Here are the credentials of this life insurance company." And quite often, they haven't even heard of some of the biggest, some of the largest insurance companies. So you have to sell them on the need for that particular company inside the stock brokerage community or the thrift community.

Secondly, you've got to contend with what is referred to in the industry as product pollution. There are lot of annuity contracts out there. There are lots of companies offering annuity contracts. You go to a member firm, you go to a thrift, you go to a multibroker-dealer operation, and if they already have one of those, even if you might have something that's just as good, they're not really interested in doing business with you because they have a product in the marketplace; they don't want to get involved with another that does the same thing.

Thirdly, the banana republic syndrome. When dealing with the New York Stock Exchange community, we have found more often than not that what happens is the insurance department starts off as a stepchild in the organization. They take a talented person from somewhere else in the organization. He's not necessarily an insurance person, and they put him in charge of running this department. One of two things can happen. He comes to the conclusion he's not interested and he's gone or he doesn't have the talent to run an insurance operation simply because he had the talent to do something else. And, he disappears on you. So, as a wholesaling organization it's a difficulty we have to contend with when you continue to go into an organization and find a new cast of characters every time you show up. That does happen on more than one occasion.

Top down support. When we go into an organization, if it's a stock broker we're trying to sell something. If it's an insurance company, we're trying to sell our services. We have to know that we have support from the top of that organization on down. You go in and if you start somewhere in the middle level where's somebody's interested, somebody understands the marketplace, and they start off without the approval of the top gun, you wind up invariably spending a lot of money and a lot of time developing product and material and ideas only to find out that the top guy was unaware of what's going on and it doesn't fit in with his philosophy of doing business today. So you wind up out in the cold after you've done all of that work.

At the New York Stock Exchange community, I believe at this point in time, top down support for the insurance product is everywhere. I don't think you could go into one of those institutions and not get it. However, in the thrift institutions, you've got a split. You've got a lot of thrift institutions that want to do business and are not concerned with disintermediating their own product. You've got other organizations that say all we're going to do is replace CDs with something that looks like a CD; are we really getting anything accomplished? And you have those two ways of looking at things. When you find one you go ahead and you work with them and when you find the other you say, "Excuse me, I'll be back in six months and hopefully you will have a change of mind." So, you need that top down support.

Multistate broker-dealers -- You have the fixed versus the variable problem. These broker-dealerships were formed to handle the variable type sales. Variable annuities, mutual funds, stocks and bonds. They tie their people together. They give them a relatively generous payout compared to what these people would get from a New York Stock Exchange firm or from a regular broker-dealer if they were just working on a day-by-day basis. Broker-dealers go into these institutions and they start to sell variable contracts and it's not long before they come across a fixed contract they're interested in selling. Now the fixed contract, like everything else, can be handled by an independent, by an individual; he can break away from that broker-dealership for that purpose and say, "Hey, this is a fixed contract. I don't need a security license, I don't need you." If he goes directly to the insurance company, assuming he has good credentials, good sales and a good reputation, they're going to license him also without paying any attention to the fact that he's part of the multistate broker-dealership. So that problem has to be contended with.

Savings and loans versus banks -- Giant difference in this country. Savings and loans have a little bit more latitude in selling life insurance in most states than do banks. I believe there are 17 banks on the grandfather's list in the United States that are allowed to sell life insurance directly. Everybody else has a problem. You've got the hard versus the easy states. In a lot of states, which we refer to as easy, the savings and loan itself can hire people, they can use their own platform people, they can hire anybody they want to sell life insurance and they can receive commissions directly. In hard states, that's not possible. In a lot of states, and it's probably in about half of them, you can't pay a bank employee a commission directly, so the bank has to hire an outside sales force. It has to put life insurance agents in place to form a different agency and have commissions paid through that agency and get its money back in some tortured manner. It's much more difficult doing business with that kind of people, but it's being done everywhere. So there is a large distinction between the two of them.

Lastly, in the areas of concern is surplus and it's probably of more concern today than it's ever been before. The insurance world seems to be running out of surplus. Everybody we talk to keeps telling us, "No, we don't want to sell $500 million. We don't want to sell $1 billion worth of fixed annuity contracts. We can handle all of your variable needs, but we can't handle all of your fixed needs." To start at the surface after the Baldwin United days and after the Charter days, people finally decided that there was a lot more risk inherent in this product and a lot more surplus strain than they reckoned for, so we don't have the supply of product today on the fixed side that we used to have. It doesn't bother us too much, however, because once we overcome October 19, and once variables fall back into place again, we happen to believe that variable sales will exceed fixed sales, seven or eight to one.

You take a look at the mutual fund industry; it's huge and it continues to get bigger! Whenever they have a faltering on one side of the sector, they pick up on the other side. Variable sales will be the wave of the future and we're building our shop to accommodate them. What do these people sell? It's very simple. These nontraditional people sell fixed and variable, single pay annuities and single pay life. Not as much single pay life today as they were selling in the past with the cloud hanging over their head; however, once the changes are made in single pay life, it's our feeling that single pay life will again come back in some form. Whether it's single pay or not, whether loan provisions are changed, it doesn't make any difference. When they do away with a good product of today, whatever remains will be the best product tomorrow. That's what the nontraditional people will sell. They're in place to do so. They will sell. How do they sell? Why do they want to sell these things? We have formulated a theory on this common ground and made it better. It's a communications system of doing things but if you can find the common ground with somebody in the sales field, and then you can come back in and show them how to make it better, you can create a niche for yourself as far as sales are concerned. When you're talking about stock brokers, broker-dealers, we made ourselves a better mutual fund by having a variable annuity.

When we're talking to banking institutions and savings and loans, we've taken their CD and we've shown them how we can make it a little bit better. For that purpose, you can draw the analogy between the two, you can sell a lot of product. You have to convince the savings and loans that the money they're going to lose on the management of the CD money on one side is more than offset by the fee and income they will earn in commissions on the others. There are plenty of people doing it now so it must be a fairly convincing story.

Tax-free municipals -- Again, going back to the equity oriented type people, or the bond type people, we just took the life insurance product and made it better with a tax-free municipal additive. Those are the ways we draw the analogies so people understand what we're talking about because when you go into these institutions, you can't be talking life insurance, unfortunately. We're selling life insurance. We're selling death protection in a lot of ways, but we're talking about something else.

The flow of money from 1974 to 1987 came out of the thrift industry and went toward the stock brokerage industry. That trend has now been about 100% reversed and it's coming out of the stock brokerage community and going back toward the thrift industry. We expect to sell somewhere in the neighborhood of $175 million worth of annuities this year through savings and loans. We're just getting involved with some banks now in a different field and I suspect that will take off, but it's going to take six months to get going. We see this money coming out of the stock brokerage community seeking a safer haven. I don't know if anybody can find a safe haven today but that's what they're seeking, so the flow of money has been reversed. How can the insurance industry capitalize on the nontraditional marketing force? They're large in number. They're quality people. They've proven that over the years. We think the way to do it is through a wholesaling organization. It doesn't necessarily have to be our wholesaling organization. There are about six or seven quality wholesaling organizations in the country. All do a reputable job. I don't think they've ever disserviced anybody that I'm aware of. They can all do the job for the insurance industry. Before the wholesaling organizations can do that job they have to face up to several problems. The main problem would be communications. There's a lack of understanding between the insurance community and the investment community.

Talking about lack of understanding. There's a man up in Michigan. He's an ice fisherman. He gets all dressed up one day, putting on a hat and coat, gets his fishing pole, and he goes out into the wilderness or at least he thinks it's the wilderness. He's out there and he digs his first hole in the ice pond. He hears a voice come up from above, "There's no fish there." The guy says, "Holy Mackerel!" He moves over another 15, 20 feet and digs another hole. He looks around and hears another voice that says, "There's no fish there." He looks up and says, "Who's talking to me?" The voice comes down, "This is the rink master." So, we have to get a better understanding of where we are and where we're going. Essentially, it's quite easy if you put an intermediary in there being the wholesaler. He's there to more or less bring to the insurance industry what the investment community is looking for or what the savings and loan community is looking for. We have to get our point across to actuaries that we're more interested in benefits for the client and a lower pay scale because we want to sell in volume. We're not going to sell face to face. We're going to sell over the telephone. We're going to sell through the teller system, so we have to have a simpler product, more consumer oriented, more like what they're selling already, and we're willing to take a lower commission.

The politics inside of an insurance company is something that we've never been able to contend with. We probably won't ever be able to contend with it but if we do get a chance to tell our story in a company where politics is not a big deal, our type of organization will work. Where there is conflict between alternative distribution systems and the internal distribution system, our system won't work and we're better off saying so right up front.

Systems in administration -- When we started working with Mutual of New York, I knew we couldn't have the same system that they used with their people. I didn't even know what that system was. I just said, as we start to work we're going to come to the conclusion that there are some changes needed. Reportedly we have climates that are different from the insurance industry. Will you be able to dig in and help with those changing requirements? Mutual of New York was able to do so. They've created a system that we've considered to be superior in the marketplace and because of that I think we'll be able to move a whole lot of product.

Speed and urgency -- We don't do anything else. We recognize when we go into a life insurance company, they've got 20 different things that they're doing, 20 different lines of business. We're only interested in our line of business. We have to get speed. We have to have urgency. We have to have phone calls returned. We have to have almost a daily dialogue with people. It just seems to work better for us and it's especially needed in a fixed area, especially when it comes to changing interest rates. We can't communicate an interest rate change to somebody after it has happened. They don't like doing business that way. It creates havoc in that system. So, we have to overcome all these problems. I think we have found ways to do so without alienating everybody.

The wholesaler, essentially, is a third party. He's put in the middle man's role of helping to develop products, of helping to introduce the insurance industry to the investment community. We talk about helping to develop products and I see some smiles out in the audience. They say, "Sure, these guys come in and tell us they need everything and if we do it, they do a great job." Otherwise the guy walks away and says, "They don't know what they're doing. I don't think so." Another story may illustrate that somewhat. There's a slightly retarded boy in a small town walking down the street and at the general store where he's heading there are two gentlemen standing there and one guys says to the other, "Here comes Johnny. Let's have some laughs at his expense." The guy says, "Watch this." The retarded child walks into the store and one guy says to him, "Hey, Johnny, let's play that game again." Johnny says, "Okay, that'll be nice." There's a third party standing up on the side watching this whole thing wondering what's going on. The one gentleman takes a nickel and dime out of his pocket and he puts them on the counter. He says, "Okay, Johnny, you can have your choice. Take whichever one you want." Johnny looks at both the coins and finally reaches down and he takes the nickel because it's bigger or at least that's the way it looks. After the two guys playing the joke walk away laughing at this child, the third-party gentleman standing up in the corner comes over to him and says, "Johnny, what's wrong with you? Don't you know the difference between a nickel and a dime? Don't you know the dime's worth more?" "Sure, mister, I understand," he said, "but if I take the dime, they stop playing the game." So, when we come in to help develop products, we recognize that there are certain constraints. We like to work with the insurance industry to overcome some of those constraints and fully recognize that they're not all economical. So, don't think that a wholesaler who comes in is going to tell you that he needs everything in the world and that you don't know what you're doing and this is the way we have to have it to make it work. It just doesn't happen that way.

Licensing -- We've got to understand there's a different licensing need in the member firm community than there is in the insurance industry. There's one example, one company that I work with which does its licensing through 13 separate sources throughout the country. It happens to have 13 regions, but when you're dealing with a New York Stock Exchange firm, you can't do licensing through 13 separate sources. It'll never get done. You won't ever be able to sell enough product. So, you have to have a central source for licensing and you have to have a special way in which it's done. It's not difficult and in fact in a lot of ways it may be cheaper than what you do already. We have learned the proper system to do that. We have a licensing department in our wholesaler group just like all other groups do, as I understand, that will help show the way the New York Stock Exchange firm needs to do business as far their licensing is concerned.

Paying commissions -- We do such things as netting which is not common in the insurance industry. It is common when selling fixed annuities in the non-traditional marketplace. Cut-off dates. Something simple as that. If the stock broker misses a cut-off date, he winds up not getting paid until the following month. By adjusting two or three days in one direction or another, we can accommodate what is needed with cut-off dates.

Expense allowance computations -- A lot of insurance companies pay X amount commission and X amount expense allowance. The New York Stock Exchange community can't have that. They have to get it all in one check so they have a different way of doing things. It's all rather easy and we can help doing that.

Statements -- A lot of insurance companies send statements to the clients without sending statements to the salesmen. It's deadly because then what happens is the salesman winds up calling you to find out what his client is talking about and it creates dialogue in two directions and nobody gets paid. It's very difficult to deal with that client. Also, it prohibits the chance to make a second sale. If the salesman gets a copy of the statement, he can go back to the client and talk intelligently about what's on the statement and generate more business. Most of the companies we deal with do not send statements to salesmen clients.

Compensation again -- I said before, we've got to have consumer value rather than anything else. Salesmen are willing to take lower commissions if they have consumer value in the product.

Life versus annuity -- As I said, I think we see a lot more annuity sales these days; also, the commission on the annuity sale is generally lower than the commission on the life sale. The commission on the life sale should be higher.

Charge backs -- I have found two different things going on in the insurance industry, neither one of which matches up with the savings and loan way of doing business or the New York Stock Exchange way of doing business. You either have no charge back in the first year without a guarantee of principal or you have a two-year charge back with a guarantee of principal. A standard in the industry is a one-year charge back and a guarantee of principal. Sometimes you can't change that product easily enough and you can't have two different products sold to two different segments of the public without getting in trouble with regulators. So, you've got to pay attention to how those products are built.

Exclusivity -- If we bring a product to a New York Stock Exchange firm and if it finds out it can go back directly to an insurance company and get somewhat of a better deal and cut the wholesaler out, it will do that more often than not. So, when a wholesaler comes in looking for exclusivity, you as an insurance company may not be able to give it to him, but you can work out an arrangement whereby you can protect that wholesaler while he's doing a good job for you. There isn't a wholesaler out there who expects to be protected if he's not producing business.

Packaging is critical and I don't mean the physical packaging which comes in this nice pretty, green, red and orange colors and that kind of stuff. But I mean, what you can do inside that package that other people do not do.

Simplified issue, essentially making an application or an order look like a New York Stock Exchange ticket. It's doable. It's being done. Field issue in the savings and loan community. Whereby they can issue their contract right there at the desk the way they do a CD. It's being done today. It's all legal.

What I call a split annuity sale on one application. I know there's some indication in the legal community that a split annuity sale shouldn't be taking place at all; however, we think if it's done in the proper manner, there's no conclusive evidence that it can't be done. If that could be accommodated on one application, you're going to be able to write a whole lot more business doing that.

The application itself -- We have seen some of the ugliest applications. They're long. They're cumbersome. They have stuff on them that has no need to be there when you're talking about an annuity. The insurance company wants to make the annuity application and the life application look the same and you can't do that. You have to simplify it as best as possible.

Underwriting -- We all know what the underwriting problems are. I think the New York Stock Exchange firm community understands why underwriting is about the most important thing that goes on in the insurance company or at least equal with the investment function. And that underwriting must take place and they're willing to do so but it can be simplified. There are systems set up that accommodate everybody.

Material -- That's the last part of the packaging. It's got to be attractive. It can't look like a contract. It's got to be salesy. It's got to be able to tell the story.

Ongoing supplies -- One of the things we have had the biggest problem with in the wholesaling industry is getting the supplies that we need. You either get none or some tractor trailer shows up with five million copies of everything that you couldn't use in 25 years because this insurance company only prints on one day of the year; and everything comes out at that time. We have overcome that by telling insurance companies essentially, not to send us too much of anything other than the point of sale brochure, and we have set up our own printing facility that can do all the printing that we need to accommodate the field force at a much cheaper price. All wholesaling organizations, at least I hope all wholesaling organizations, submit all their material to the insurance company for approval before they ever print it. So, we overcome waiting in line or getting just so much material that we can't use; it makes no sense.

The future of the nontraditional market place -- I think it depends on a number of items that are happening as we speak today, legislation being one. What's going to happen to single pay life? My own feeling is it's going to be altered significantly but we will be able to sell whatever comes down the road. It will just be the best thing available at that time. We will forget about what we had yesterday. If it doesn't change all at once, it will change part by part and the savings and loans and the banks will be in the insurance business and will sell a lot of products.

Continuing education -- There are a lot of states around that are mandating continuing education. I think we'll see a fair number of stock brokers fall by the wayside as far as being life insurance agents. They won't sit for the 40 hours or the 30 hours or the 500 hours of education requirements necessary to maintain their life insurance license. That bodes well with a life insurance agent and overall probably bodes just as well for the life insurance industry, because we'll have people more qualified selling the products.

Professionalism -- That's something that each one of us must elect for ourselves, to go on and continue to educate ourselves. I think both the insurance agent and the nontraditional agent will go on and do so.

One interesting trend taking place these days is defection from the member firms whether it would be forced in the case of a member firm trying to skinny down a little bit, getting more profitable, whether letting people go, or in a lot of cases, a lot of member firms' salesmen who come to the conclusion that they are better package salesmen. They can sell life insurance. They can sell mutual funds. They can sell everything else but stocks and bonds. Really, they're paying a dear price to be with the firm just to sell stocks and bonds. So, they're breaking away from their firms and forming small financial planning shops. Some of these guys are some of the biggest producers in the firms. They will be a major force in the insurance industry in my way of thinking. Essentially what's going to happen as this education takes place, and the war between traditional and nontraditional takes place, we're going to find more and more people selling a little bit of everything, rather than what we see today where the nontraditional people really are stuck in the mud of selling only the annuity and the single pay life.