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WHAT ARE THE NEW NICHES IN DIRECT RESPONSE MARKETING?

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- o New products
- o Database marketing
- o Relationship marketing

MR. M. NASIM ALI: We have put together a distinguished panel of speakers with many, many years of experience in direct marketing, both in the marketing side and the actuarial side of the business. Many of you are probably thinking that direct marketing itself is niche marketing. Those of you who work in the direct marketing area know very well how hard it is these days to make profitable solicitations. Response rates are declining and solicitation expenses are going up; hence, acquisition costs are practically getting out of hand. So, like other distribution channels, niche marketing has become a necessity for the direct response marketing distribution system to market insurance products effectively and profitably. Our panelists will discuss what a niche is, how to identify a niche, and special considerations for marketing a niche through direct response. They will also provide examples of marketing to a niche. They will discuss product development and product testing for a niche market. Our first panelist is Mr. Neil Lund. Neil is the Senior Vice President and Chief Actuary at Monumental General Insurance Company, which is a major mass marketing company in the U.S. Neil is the immediate past chairman of the Non-Traditional Marketing Section. He serves on a variety of industry committees dealing with direct marketing. One other thing I found out is that Neil is a race car driver, and I like his strategy in race car driving. He says you either win or crash.

MR. H. NEIL LUND: I first decided to find a good definition of a niche. Of course, I turned to Webster and looked it up and quickly discovered that a niche is "a recess in a wall." Somehow, it just didn't strike me that we would be talking about walls.

A second definition given by Webster is "a place, employment, or activity for which a person is best fitted." Since we tend to think of niches as subsegments of the marketplace, this is probably not what our preconceived ideas of a niche or a marketing niche are. Are we talking about walls, or talking about something that is best fitted for something else? So I searched further. I turned to a fairly common source for people these days -- *In Search of Excellence: Lessons from America's Best Run Companies* by Thomas J. Peters and Robert H. Waterman, Jr. -- and sure enough, they devote a large section of the book to what they call nichemanship. But again, their definition is probably not what we normally think of in terms of niche marketing.

In fact, their definition is, "the customer orientation is by definition a way of tailoring, a way of finding a particular area where you are better at something than anybody else." But, we are starting to form something here. The niche in niche marketing is not strictly involved in identifying a particular piece of the market. Rather, it's a matter of defining or tailoring something that you or your company can do better than anyone else. In other words, the niche starts with you and your company.

Peters and Waterman go on to identify five fundamental attributes that pertain to niche strategies or niche marketing:

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1. astute technology manipulation
2. pricing skill
3. better segmentation
4. a problem solving orientation
5. a willingness to spend in order to discriminate.

I would submit to you that all five of these attributes are applicable to the insurance industry and that these five attributes do indeed define for us niche marketing. Let's break them down and look at them one at a time.

The first is technology manipulation. While we often tend to think and believe that there's nothing unique to any given company in the insurance industry and that we all share essentially the same technology, I think this is far from true. Technology for us extends beyond our computer systems. We have to think in terms of technology and the manner in which we reach out to the customer, whether that be by phone, print, other media, or face to face. I tend to view our industry as one of communications, and therefore, staying fully abreast of the latest technological developments and exploiting those technological developments in all forms of communication is an area where we can develop an advantage.

The second attribute is pricing. Pricing skill for us extends beyond just claims studies and expenses, commissions, and adding up the components. We must understand and utilize the perceived ideas and perceived values within the marketplace and match our pricing to that. Match price with expectation.

The third area is better segmentation. Most of us in the direct marketing area are familiar with segmentation. For direct marketing, that is the breaking down of lists based on certain characteristics or combination of characteristics. Those characteristics may be demographic: age, location, sex, and so on. They may be economic based: income levels or wealth indicators. Also, they may be psychographic: how the individual perceives themselves based on the type of purchase they make, magazines that they subscribe to, or other criteria. In any case, it's a matter of culling out the people that have a low propensity or need for our services and concentrating our efforts on those that we identify with a high propensity. A great illustration from *In Search of Excellence* is an indication of one individual as a salesperson for general instruments who had sales at 195% of his quota and was the top in his division. The corporation, however, noted that he was averaging just 1.2 sales calls per day and the company average was 4.6. The company thought, "just think of what you could do if you got your average up to par." The salesman thought, "Just think of what the rest could do if they could get their calls down to 1.2." The point here, and I've seen this especially with agent companies, is that the thrust is to increase the number of contacts made, not quality of the contacts. We may be better off, as we've often found in the direct response industry, concentrating on fewer sales contacts but being more effective in those fewer sales contacts. This is segmentation.

The fourth area is developing a problem solving orientation. Our customers purchase from us to solve a problem or cover some concern that they have. Our concentration needs to be on examining what sort of problems our customers have and how we can solve them. Note that customers is plural in that we all have multiple customers. This ties back into product development. We need to develop a continuous flow of new products or solutions to problems if we are to be problem-solving oriented.

The final area mentioned is a willingness to spend to discriminate. I'm reminded of something someone said to me when I moved into a marketing area with a prior company. This individual's goal was to make money, not to save money. I find this to be a very healthy attitude in niche marketing. Your goal is to make money, not to save money. However, when you spend money on anything, it must be cost effective. But to avoid spending money wisely on segmentation, on computer services, or additional information, simply to stay within budget and therefore reduce the effectiveness of what you're doing, is foolish.

This is the theory as expounded upon by Peters and Waterman. Let's look at this in practice. The company I'm going to use for practice is my own company, Monumental General, because I happen to feel that we are a very good niche player. In examining us against the five attributes, I find that there is a good correlation in what we do.

While I don't know if we'd classify ourselves as astute users of technology or astute manipulators of technology, we are active users of technology, whatever technology is available and makes sense and appears to be cost effective for what we're doing. Whether we buy or lease the technology -- whether it be in the print area, computer services area, or risk management or segmentation area -- makes no difference. It is our goal to effectively use technology. We have a high level task force of people who deal in the systems and technology area. To put it another way, we're not afraid to use technology and we're not tied to the old ways of using technology or old technologies. On the other hand, we do not use new technology just to be on the cutting edge. Its use must make sense.

The second item is pricing skill. Call it skill or luck or whatever, but one distinct advantage that people trained in the direct response area have is recognizing that certain prices have more sales appeal than others. Pricing is not adding up the pieces and examining ROE. For example, if our initial pricing shows a price of $8.15, the final price is not going to be $8.15; it's going to be $7.95. Pricing is an area where we listen very closely to our customers, be they our marketing people, brokers, third party administrators, or the ultimate consumers themselves. What we try to determine is what the perceived value of the product is. Also, the direct response media gives us the advantage of constant feedback from our mailings when it comes to the public perception of price. We test both products and prices and constantly analyze our marketing results. When the response falls off, we may need to increase price. The perception of the public may be that we have underpriced our service, and that it is too good to be true. If a product is not making money, the answer may not be to raise prices but rather to lower them. The correlation between perception or perceived value and price is critical.

The third area is better segmentation. We always examine and critique ourselves to determine what is working and what isn't. We also hope and feel that we are sophisticated enough so that we do not segment ourselves into claim problems, but rather keep a good risk distribution while segmenting ourselves into higher responding segments. This includes a feedback loop of examining what we've mailed and what worked and what didn't, attempting to analyze why it worked or why it didn't, and focusing in on those characteristics that allow people a propensity to buy or conversely those characteristics of individuals who do not buy. This is perhaps a roundabout way of saying that we always critique ourselves to do better segmentation. However, better segmentation does not imply more segmentation or to narrow down to the very few people who will purchase something. In fact, as with pricing, sometimes it means the opposite. There are situations that we encounter where less segmentation is better, more cost effective, segmentation.

The fourth area is problem solving. Here, I would like to categorize us as having an objective of a six month shelf life for all of our products and of bringing a new product or significant revision to the marketplace every month. I'll be very candid and admit we have not met this objective yet. But, we shortly expect to reach the point whereby every product is analyzed for effectiveness in the marketplace and overall profitability every six months and revised as necessary to keep the product competitive and current in the marketplace, meaningful to the customer, and profitable. The days of the rate book lasting for several years are long gone. The message for us is that the product portfolio needs to be revised on a continual basis, with each product having some expected life span. Some products may last only one mailing. Some products may even last for a couple years. But problem solving goes beyond products designed to solve problems. We endeavor to discover the problems of all our customers.

By customers I mean our brokers, financial institutions through which we sell regulators, our own administrators and claims areas. These are all customers. Each has problems. If we can help solve them, then we will win. Even seemingly small problems such as the wording on the explanation of benefits on your claims checks need to be rigorously attacked. Every solution brings you closer to your customer. My personal bias is that a problem solving orientation -- an active orientation -- is the key to being a quality niche player.

At last, the final piece -- the willingness to spend in order to discriminate. We give our marketing people a rather significant budget in terms of total dollars each year to spend in marketing endeavors. We expect them to spend it wisely. However, we don't tie their hands. Marketing is free to reallocate dollars as needed. If opportunities arise that go beyond the budget, we are readily willing to raise the money. For us this usually means outside sources. The significant factor here is when it comes to marketing, the marketing endeavors, or spending money to produce profitable business, we are willing to do it. We are extremely tight with expenses in the overhead areas where expenditures do not relate in any fashion to the direct production of profitable business. Overall, we believe that the five attributes as they apply to nichemanship or niche markets apply to us as a company -- things we readily attempt to do every minute of every day.

In conclusion, our niche, and your niche, is not a recess in the wall. And it is not a small segment of the U.S. or Canadian marketplace. Rather, it is a set of actions starting with you and your company. These actions can be learned and can be applied to everything you do everyday in your business. Once in place, nichemanship is automatic.

MR. ALI: Our next panelist is Mr. John Martin. John is a graduate of Texas A&M University. He was commissioned as an officer in the U.S. Army after graduation. After leaving the Army as Captain, having been awarded at least a dozen medals, John joined and served 11 years with Beneficial Corporation, a financial services company. After Beneficial Corporation, John joined American Security Group as a marketing vice president. American Security Group is an insurance group specializing in the marketing of credit related products, annuities, and investment products to financial institutions throughout the U.S.

MR. JOHN A. MARTIN: As I reviewed the material for the session, one of the issues over which every direct marketer is concerned came to mind. The issue is the quality of the information with which he has to work. It is almost impossible for me to think about that subject without thinking about George Gallup, Jr. Several years ago, I attended a conference at which George was the guest speaker. After his remarks, he was regaling a group of us with stories producing unlikely results. The point he was making was how important it was to structure the questions clearly in order to elicit a response within a given range. George sited two examples of the "best laid" plans going awry. The two specific questions I am referring to were a part of a survey of all departmental supervisors within agencies of the U.S. Government. The first question was intended to determine how long the supervisor had lived at his current residence, and the Gallup staff shortened the interrogative to: "length of residence?" With what must have been considerable diligence, one supervisor pondered the question and came up with this answer: "I do not have the specific data available at my office, but if memory serves me correctly, it is 47 feet long." The second question to the same group of supervisors related to the composition of their department by gender. The question was stated as, "how many people do you have in your department, broken down by sex?" The mind boggling answer was: "We do not have anyone broken down by sex, but alcohol seems to be a problem!" The quality of information gathered by a decentralized organization is dependent on the clarity of the instructions for capturing the data and the discipline with which they are enforced.

We will talk specifically about that subject later, but let's go back to the general topic of my presentation: marketing insurance through financial institutions. There are specific cultural differences between banks and insurance companies. Banks are transaction oriented. Administration and accounting are their strong suits. Once they get the consumer through their doors instead of XYZ bank, the consumer states his need whether it be a checking account, trust services, or a toaster oven! Most financial institutions have long since abandoned toaster ovens for more competitive strategies, yet there is a paradox in bank and thrift marketing. Ask any bank what their most valuable asset is and they will answer their customer list, but in order to more economically and efficiently handle transactions they have created strategies that reduce cross-selling opportunities. One example is ATMs, which are incredibly convenient for consumers but they divert traffic out of the lobby. In lowering their processing costs on loans, many have gone to lines of credit that can be accessed by credit cards, ATMs, or checks, but again, this convenience reduces the consumer's need to visit the branch. The affinity of that customer to the financial institution then depends to a large degree on trouble-free administration. Further, when the customer does visit the branch, they are often handled by some of the bank's lowest paid employees. That handling also promotes or detracts from the consumer's affinity to the bank. Although the platform personnel in the typical bank have around 100 different products or services available through the bank, it is unlikely that the staff will aggressively promote them. Usually the consumer controls the conversation, specifying the transaction he wants to complete. Often that transaction concludes with: "Thank you for opening this account. Is there any other way I can help you? No? Ok, thank you again."

An insurance sales entrepreneur would call that person referenced above an order-taker. Banks have responded to this real criticism by implementing "needs oriented" selling programs. In many cases, banks have structured employee incentives for given levels of performance, and in other cases they have built performance levels into their management by objective guidelines through which they rate their employees. The point is that as a general rule, banks and thrifts have not historically promoted sales cultures, but most are clearly orienting themselves in that direction. Insurance companies have always been aggressive needs oriented marketers. Through our agents and brokers, our industry has had to aggressively go out and round-up their prospects and buyers. The agent is typically an entrepreneur and self-motivated person. Besides the aggressiveness displayed by agents, our products have also been perceived negatively as they say to the consumer, "You are going to get sick and die." Frankly, the consumer would prefer to do neither, and instead, buy a high definition TV set with his money. You can see that the two cultures don't necessarily fit hand and glove. So the marriage may not be a quiet affair.

Gaining total support of the financial institution is a pivotal step in making any program work. There are three critical points to the success triangle:

- Senior management support is the first critical ingredient and it must start at the top and go all the way down to the branch manager and platform personnel.

- Training is also a key element around which successful programs are built. An example is referrals. The bank employee simply needs to know the difference between a referral and qualified referral of a person who has the disposable income to buy your product, and how to make a referral to the insurance entity without undue effort.

- Incentive is the "make or break" leg of the triangle. Whether the incentive is a carrot or a stick, it must be monitored and enforced by management.

  The answer to successful branch insurance sales is the success triangle, a cohesive approach to just another product, insurance.

There are two ways to structure the insurance venture. The first is the agency approach, where agents sit in offices in the branch. Thrifts and savings banks have been very successful with this approach, whereas commercial banks have not been. In thrifts and savings banks, the people in the overall organization understand what their role is and understand their objectives to effectively make referrals. In commercial banks, part of the problem has been the clash of cultures. The branch manager, who may be graded on deposits, is concerned about erosion of deposits because of new equity products that the agents are selling.

The second way to structure the insurance venture is through direct marketing. The mission statement of direct marketing is to match buyers and products. A series of segmentation steps are necessary to determine who those buyers are and what their particular needs are. As pointed out earlier, this is the real challenge of direct marketing. Products can vary from simple accidental death to term, universal life and annuities. Obviously, consumers buy supplemental products -- direct marketing companies have been built on them. Although creative advertising plays an important part in painting the consumer's need for the product, it is critical to have the product fulfill expectation. Like agency marketed business, persistency is necessary for long-term success. Setting realistic goals for the marketing entity is important in order to be able to manage the program to the expectations that have been created. In short, what sounds simple in theory, merging two cultures, is incredibly difficult to execute. Time and money are key ingredients to success.

Earlier, the customer file was identified as a valuable asset. Some are more valuable than others! The value of the file depends of the quality of name, address and relationship information. In collecting data remotely in branch locations, disciplined input is necessary. Something as simple as name can be incorrectly recorded if a procedure is not followed, i.e., entry of last name, first, middle initial, honor code.

Address changes are slow because the postal service continues to deliver first class mail beyond address change deadlines. Third class mail to the address changes in that same file will not be delivered. This can be overcome with national change of address files.

Relationship information is important, since the most active account is usually of the strongest quality. Scoring the individual consumer file for response parallels the steps for scoring for credit, but instead uses response data from regression analysis.

The value of the customer file also depends on the quantity of information available such as age, marital status, family size, home ownership, recency of transaction, and frequency of transaction. Most banks have this primary information on their input screens -- it is a question of whether the platform people in the branches are actually collecting it. If they don't need it for their transaction, they won't collect it. In short, it is not the end of the world if data are not available on the file, for it can almost always be enhanced from outside sources.

Name and honor codes can all be straightened out. However, it costs money to accomplish these tasks, and therefore the value of the list bears directly on the quality and quantity of information available in its raw form. Finally, storing the marketing file data gathered during past campaigns represents a considerable resource. Establishing a marketing data base of buyers is important because direct marketing offers the ability to cost-effectively upgrade and cross-sell product based on buyer information in your file.

In closing, it is obviously not an easy task but it can be accomplished with persistent goal-oriented management.

MR. ALI: Our next speaker is Mr. Brad Smith. Brad is an associate member with the Dallas office of Milliman and Robertson. His area of expertise is individual life and health insurance benefits, particularly the development of these products as they relate to the overall strategic direction of the company. He has significant experience in the successful development and implementation of nontraditional distribution systems, including direct response marketing. He has also dealt successfully in assisting companies with their surplus management. Brad is also the current chairperson of the Nontraditional Marketing Section of the Society.

MR. BRADLEY M. SMITH: When Nasim called me about ten days ago, he said that we were talking about new niches in direct response marketing, and asked if I would please discuss new product innovations as they relate to the new niches. Unfortunately, I am probably the wrong guy because I hold a contrary view. I believe that success in selling insurance using direct response markets or methods is dependent upon successful identification of a market, not the creation of an innovative, unique product that has no specific appeal to a previously identified market. Identifying the perceived needs, as Neil said, of an identifiable group of homogeneous individuals, and creating a product to fulfill those perceived needs, will enhance the probability of having a profitable marketing effort. If you have, or can create, an affinity with this homogeneous group, your success will be assured. The main point I am making is that the selling of insurance through direct response methods is market driven, not product driven.

My assignment is to discuss products that have appeared in the market place over the past few years. Specifically, I will discuss the following product innovations. One product concept that we have seen is the return of premium, if the policyholder persists a certain number of years. Another product that has just been introduced is the accelerated death benefit rider associated with any existing policy. Additionally, I will touch on reverse mortgages and tax deferred annuities, since I've just gotten an interesting offer through the mail. I'll touch on specific need orientation and just touch a little bit on the effect that the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) has had on new product development within direct response.

The return of premium product has been around for many years. It started with the return of premium, if after ten years you had no claims on disability income. The product has emerged over the last two or three years as the return of premium if the policyholder persists a certain number of years. This product attempts to attack the success elements of a direct response marketing effort. Clearly, the two criteria that most affect the profitability of a particular solicitation are the response you get from that solicitation and the persistency you get. Everything else is overwhelmed, including the interest rate and your overhead expenses, which presumably are known. The morbidity costs are relatively set. The mortality cost associated with these offers is pretty risk free, the persistency and the response rate are not. What this product does is insulate a company from swings in persistency. If you have priced it properly, it does not affect your profitability if the policyholder lapses after a few years.

One problem that Neil mentioned, and I know it's a problem with this product because I've seen it happen over and over in focus groups, is that the marketplace believes that the product is too good to be true if you make the product too good. If you have the return of premium benefit too early, the market will not believe that the product is supplying or providing the benefits that you say it is supplying. They feel like there is a loophole, and they will not buy it. Actually, I have seen it tested at 10, 12 and 15 years and later, and it seems the optimum period of time is 15 years. If you design the return to be 15 years, you have to raise the premium about 10%. If it is ten years, you have to raise the premium significantly, and you are swimming upstream as far as response goes. This is because, first of all, the people don't believe it, and second, the premiums are too high. The optimum period of time is 15 years. All of these products that I'm going to discuss are addressing a need that the markets feel, or addressing a weakness the markets feel in a particular product. As you can see, the objective of this product is that it attempts to increase the value perceived by the policyholder. This was particularly critical three, four or five years ago with HIP coverage (Hospital Indemnity Protection), because the public perceived its need for hospital protection had gone down. The probability of entering a hospital for any given sickness or accident is decreasing, and the time that you are going to stay in the hospital is less, so they don't feel as great of a need for HIP protection. The return of premium combats that by telling those who buy and use the product that they will get their money back. Finally, a secondary reason for this product is that it helps you in your loss ratio filing with the state. Because hospitalization has decreased and length of time you stay in the hospital has decreased, your loss ratio has decreased to unacceptable levels. The return of premium benefit increases the loss ratio depending upon the persistency that you assume.

This product does create some problems for policyholder marketing programs. I am sure I'm not revealing any secrets to those of you involved in direct response marketing, that policyholder marketing is a substantial source of the profitability of the marketing program. There are many front-end programs that are not profitable and are totally dependent upon back-end profitability. Obviously, your policyholder marketing is divided into two pieces; the rider solicitations to the existing policy and cross-solicitation of additional policies to your existing policyholder base. The problem with the return of premium benefit is that it really limits the rider solicitations that you can make, and that's because your primary selection criteria when you are doing policyholder marketing is the time since the insured bought the original policy. The longer you wait, the less likely the insured is to buy one and eventually will fall off the solicitation list. Again, it's no secret that for an active policyholder list, it will take six to seven years to fall off of that solicitation list. The thinking is that after six years if you haven't bought one, you aren't going to buy one. The problem with this product is that most companies cannot delineate in their master file the difference between the rider premium and the policy premium. For example, with a return of premium after 15 years, if you solicit a person seven years out from original issue, and you are going to return that rider premium in the 15th policy year, you only have eight years to recoup your solicitation costs on that rider and obtain your profit objective. What this product has essentially done is cut the solicitation period for riders from 6-7 years to 2-3 years.

The next product I would like to talk about is accelerated death benefit products associated with any existing policy. The benefit offered under this policy or rider is to prepay the face amount of an existing policy issued by any company if the insured contracts a specified dread disease or if he enters a long term care facility. The underlying policy does not have to be identified at the time of application. Coverage can be offered on a guaranteed issue basis with a pre-existing condition clause built in. A policyholder must assign his life insurance policy to the insurance company offering the accelerated death benefit protection. The company providing the accelerated death benefit protection assumes all rights of ownership of the policy. This policy must offer permanent protection for obvious reasons. If there is no policy at the time of the claim, there's no accelerated death benefit protection. Pricing must consider the payment of the premium for the life insurance policy once it is assigned, as well as the time value of money from the time of contraction of the disease or the confinement in a long term care facility, until the time of death and receipt of the policy proceeds. Capital Holding has developed a product utilizing this basic description that I've stated. Possible impediments to the successful sale of this product through direct response methods include regulatory constraints, as well as difficulty in accurately communicating the protection offered by the product. I believe this product offers the potential for mass appeal through direct response mechanisms because a vast market exists and it can be offered with very affordable premiums.

The next product I would like to talk about is reverse mortgages. Reverse mortgages attempt to provide living benefits to the owner of a home by extracting the equity from the property and paying it to the aging homeowner. It is a home equity loan marketed to older members of the population.

Just as the return of premium policy attempts to combat a weakness that people have seen, that is the decreasing utilization of HIP coverage, the accelerated death benefit associated with any existing policy, reverse mortgages, and tax deferred annuities are targeting a specific market. They are addressing the point that the population in the United States is aging. By the year 2000, 13% of the population will be over 65 years old. Currently, there are 2.2 million Americans over age 85, and that's projected to be 5.1 million in the year 2000. One of every five will need long term care protection. Since I am addressing the products, it appears that I am addressing a product orientation or a product driven market. But this is really products designed to address certain needs of the market. I believe it is market driven.

The tax deferred annuities are very interesting. I got a piece in the mail the other day from AMEX Life which offers Gold Card members a tax deferred annuity plan. The general thinking has been that you couldn't offer flexible or single premium deferred annuities through direct response and make money. I think that this product has a very good chance of making it. To see what the potential for success was, I ran a few profit studies and would like to review those. Assume that the premium was $200 a month. Although it is a flexible premium deferred annuity, the premiums are taken from your Gold Card. So once you've signed up, there's really no premium discontinuation possibility. It's a back-end loaded product. It has surrender charges for seven years. It offers you a guaranteed interest rate of 12% until July 1, 1990. I believe the guaranteed interest rate after that is 5%. You pay your premiums with the Gold Card. The minimum monthly premium is $50, but the definite emphasis within the piece is for $200 a month. For some reason, you have a $3000 per month maximum. So I use a $200 per month premium in this analysis, and use $25 per policy per year as maintenance expense and .5% of premium. I assume that the annual persistency is 95% per policy and 90% of premium. I believe that the premium persistency will probably be better than that. I assume that the cost per 1000 mailed was $400. It was mailed through first class. It's strictly a two page letter, a one page application, and a brochure. I assume two different response rates; .5% and .2%, figuring that those were the minimums they would accept. I have not taken into account any policyholder marketing potential. I assumed an interest spread of 100-150 basis points notwithstanding this 12% guarantee. I calculated profit margins as present value of profits, discounted at the investment earnings rate, divided by the present value of premiums on a pretax basis.

Every cell is profitable. With a response rate of 0.2%, which is incredibly low, and with a 100 basis point spread, the profit margin after 20 years is 5.5%. This is obviously not an insubstantial amount of profits. With a response rate of 0.5%, which I think is probably a more realistic response rate, and with a 150 basis point spread, the profit margin is 10.7%. I really don't think that they are going to get hot money with this product, so they aren't going to be subjected to the risk of interest rate swings as much as flex annuities sold through stock brokerages. My guess is that they will make the response rates, and premium and policy persistency will be as good as I assumed. I think they probably have a winner here.

I have also tested $50 per month to see if they could make it on a smaller premium. With a 0.5% response rate and a 150 basis point spread there was a 3.2% profit margin. This is a much smaller profit margin but seems to be the worst case.

There are products out there that try to address a specific need such as tuition accident. The problem with those is, even though they are generally highly responsive, it is a very limited market and it's difficult to get any substantial numbers.

One of the things I did want to mention is the effect of TAMRA on products. Everybody said TAMRA is a disaster, and it is. It was going to eliminate the modified death benefit policies because they become a modified endowment under TAMRA and you'd be subjected to different taxation of the proceeds. However, I have not looked at any modified death benefit permanent policies that created any gain upon withdrawal. There were no ramifications to being a modified endowment under TAMRA. There is no potential for gain with these products.

The last thing I wanted to talk about is disguise offers of insurance, or the indirect approach. The approach is to divert attention away from the sale of insurance to some other aspect of the offer, such as credit card protection services or benefits offered to members of an association, or the availability of free insurance for some specified period of time. The offer does not typically look like one whose primary purpose is to sell insurance. Response rates are typically high, as are the cancellation and first year lapse rates. I have seen some of these products that have 70% first year lapse rates. There is euphoria in the first four months of selling these because the response rates are unbelievably high. After you've capitalized all your costs, you realize that there's only 30% of the premium still out there and it's about to leave. These can be successful, and as in any other direct response marketing attempt, the key to successful completion of this marketing effort is to obtain the credit card number of the potential purchaser. Thus, the credit card protection is a natural lead offer. However, the ultimate success or failure of such a program will be dependent upon the affinity created between the purchaser and the offerer, which is not typically an insurance company, with the lead offer. One additional consideration before you jump into this approach is that it seems certain that we will see increased regulatory involvement.

In conclusion, I do have a contrary view and I always find a few things that Neil and I agree on and a few things that we disagree on. We obviously agree on the importance of perceived needs. We agree on the importance of being willing to spend money, although I would never use the term spend. I would say you shouldn't spend money, you should invest money and I think he would agree with that. One of the things that I do disagree with him on, though, is on the shelf life of the product, and it has to do with my market orientation as opposed to product orientation. I believe that HIP, HAP, AD&D and Term Life will continue to be sold profitably to markets having a high affinity with the apparent offerer, not necessarily an insurance company. If you created the affinity, and have identified a market, I believe that you can sell these products. I also believe that offers to the existing policyholder base will increase. We have seen that over the last few years. It used to be in the early 1980s that if you didn't make money on the front-end offer, you would not sell the product. That's clearly changed. It changed first with the people that were selling insurance through TV. Now it's made full circle, where people that have a high affinity credit card base or association base are willing to go in the hole on the first offer knowing that they will make money in later offers.

MR. HAROLD D. SINGH: Can you explain reverse mortgages?

MR. SMITH: Reverse mortgages are strictly home equity type loans marketed generally to older individuals who have paid off their mortgages. It's basically a way for them to extract either income or a large amount of capital by re-mortgaging their house.

MS. AMY HELEN COLGLAZIER: Do you have an objective of a new product every month because of an expected high failure rate or because of all the markets you've got?

MR. LUND: We have a large portfolio right now and part of the objective is to keep a reason for our marketing people to be going back to an institution. It's a reason to go back and talk to that level of the customer. Another reason is that there is a core of products that continues to work. But what we are trying to do is create the perception that what we're attempting to do is solve the problems. That may mean repackaging of an existing product or blending a rider from something that you've used in one marketplace and introducing it into another marketplace. You need to be very creative in the use and packaging of what you have got. Tailor it to the current problems. If you create the perception in the mind of your customer, and in this case, the customer is the financial institution, that you are able to solve problems for them, they will attempt to use that product. The other thing that I really believe is that in testing new products, if you can hit one out of four, you're doing great. But if you are only hitting in one out of four, you're failing three times and you have got to have some turnover there to come out with the ones that hit.

We deal with a lot of financial institutions and they vary in quality. One of the things that John brought out was management support, training, and incentive as a triangle that's there. When we evaluate an institution or customer, all three of those are present in the institutions that we enjoy doing business with. At least one of them, if not all three, is missing with the institutions that we don't enjoy doing business with. We try to sell them on the idea that first of all there has to be management support, there has to be training, and one of the things that John didn't touch on is that training wears off. You have to have a program that comes back and repeats training. Finally, there has to be incentive. People work for incentive. All three elements have to be there. Interestingly, the incentives don't have to be cash. They can be very simple little rewards of some sort, some form of recognition. But the incentive and recognition have to be there.