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INTERNATIONAL DIRECT MARKETING

Moderator: KIRAN DESAI
Panelists: BRUCE D. BARTON*
ROBERT O. DAVIS**
JAY M. JAFFE
H. NEIL LUND
Recorder: MARIA N. THOMSON

- o Current trends in international marketing
- o Product pricing considerations for markets other than the United States
- o International reinsurance

MR. KIRAN DESAI: We will talk today about current trends in international marketing. We will split that up into Europe and Asia. We will talk about product pricing considerations for markets other than the United States, and about international reinsurance.

The world is getting smaller. With the fax and Concorde you have the ability to respond very quickly, but by the same token, what happens across both the Atlantic and Pacific can alter and shape our lives here. Four years from now, when we will be considering reelection of Bush or Dukakis in 1992, Europeans will be getting ready to cope with their own metamorphosis of the United States of Europe. They will be planning to leave us struggling behind to retain the third place in the world insurance market. In the last 15 years, from 1970 to 1985, the share of life insurance premium for the U.S., as a percentage of gross national product, has stagnated; while it doubled in Japan and France and increased by over 50% in the United Kingdom and West Germany. So when we get these 12 countries together, we will have quite a race to stop the momentum, or learn to live with it and profit from it.

Sir Winston had a dream in 1942 of the United States of Europe. Neil Lund will tell us about this dream while Bob Davis will take us through scenarios in the miracle grow lands of Asia: Japan, the four little dragons (Taiwan, Korea, Hong Kong, Singapore), and Malaysia. Bruce Barton will outline the role of reinsurance. So that we can accomplish all that, Jay Jaffe will review how to get there with your floppies intact.

* Mr. Barton, not a member of the Society, is Vice President of Individual Life at Lincoln National Life Insurance Company in Fort Wayne, Indiana.

** Mr. Davis, not a member of the Society, is a Partner of Weber and Davis International in Chester Springs, Pennsylvania.

First, we will start with Jay Jaffe. He needs little introduction. Jay is the President of a consulting company in Direct Response Marketing and has done International Direct Response speeches all over the world, including in Montreal, and I am sure he has a lot to tell you.

MR. JAY M. JAFFE: The topic is international direct marketing. It refers to direct marketing throughout the world but it does not mean the direct marketing of insurance on a multinational basis. While there are a few instances of companies marketing products across national boundaries, most of what occurs is on a single nation basis, or perhaps, within a group of countries such as is occurring within the European Common Market.

My remarks will be based on my experiences in international direct marketing. I'm sure that others on the panel will explore with you such areas as the current status of insurance direct marketing within the European Common Market, the Far East, and other parts of the world.

From a consultant's point of view, there are several aspects of direct marketing on an international basis which should be of interest to you, even though they aren't really actuarial. The first of these topics is transportation.

If you have the opportunity to travel overseas to a client, customer, or parent company, remember to allow for jet lag. Everyone has his or her own solution to this problem. I cope with jet lag in one of two ways: either I set up my trip so that I have no time to worry about jet lag or I give myself at least a day to overcome the several hour time difference which I'll encounter on a trip to Europe.

About 18 months ago I made one trip overseas where I left Chicago for Europe on Sunday, went directly from the plane to my client's office on Monday, managed to stay awake until 10:00 p.m. Monday, worked Tuesday, had dinner Tuesday evening in another European city, had a meeting Wednesday morning, and returned to North America that afternoon. Jet lag was never a factor during the trip because I never had time to let down, but boy did I feel the effects of the trip when I returned home. A lesson to be learned from this experience is to allow for jet lag on the back end of any trip just as you do on the departure leg of the journey.

While traveling, take good care of yourself. There's nothing worse than meeting someone on their turf while you are feeling lousy from the long trip, excessive drink, lack of sleep, etc. I recommend that on a short duration trip you ask to fly business class because of the amenities including extra leg room. Of course, if the place is empty, you may prefer to take three seats and stretch out in coach.

Be prepared to suffer from sticker shock when you travel today in many parts of the world. If you think New York is expensive, just visit most European cities and you'll see how how little the U.S. or Canadian dollar buys overseas. I had a room a while back which cost $200 per night, but was so small that I could just about touch all four walls from the foot of my bed.

The miracle of the modern day personal computer brings the world closer together. During a visit to a client in Italy, I brought along a disk with a Lotus program, and was trying to impress my client how it easy it was to use. LOTUS is just as popular in Europe as it is in the U.S., but I forgot that Europeans use commas for decimals and decimals for commas when displaying numbers. Naturally, my program wouldn't work until I realized that European LOTUS required me to reverse my commas and decimals. Believe me, I'm not making a large issue about a small point.

Now that I've gotten you to your destination in good shape and have alerted you to potential computer interface problems, let's compare direct marketing in the U.S. and in other countries.

The most important difference between the environment in the U.S. and other countries is size. The U.S. is the world's largest viable insurance market. By this, I mean that the market is accessible (by mail, phone, television, etc.), the market is attuned to insurance, and the market has the disposable income to buy insurance. While nations such as China, Russia, and India have large populations, the insurance market in these areas is nil at the moment because of communication difficulties, the lack of need for insurance, and the lack of disposable income.

The population of Mexico is roughly 70 million but there may not be more than three or four million people with an interest in insurance; and communication services for direct response marketing leave much to be desired in that country.

In marketing outside of the U.S., you must recognize the relatively small population. Even the largest countries in Europe probably are only a quarter to a third the size of the U.S. market, and many countries may only have populations of a few million.

In marketing insurance in smaller markets, the expenses of doing business cannot be ameliorated by volumes of insurance applications. Therefore, some allowance must be made either for higher acquisition costs of doing business or more efficient operations have to be developed to hold costs to acceptable levels. There are still some instances where high response rates outside of the U.S. will at least offset part of the operating costs at reduced volume levels. But as sure as the sun sets in the West, sooner or later the luxury of higher response rates will disappear and our fellow marketers outside of North America will have to deal with the reality of lower response rates from saturated markets which will accompany a mature industry.

Another issue which a North American company must immediately face if it desires to market insurance outside of its home country is currency fluctuations. Because direct marketing often requires up front dollar commitments, if the dollar fluctuates in value in the wrong direction, you may wind up having a great insurance promotion but lose your shirt because you can't recover your original investment. Remember, the policies you'll sell will be in local currency, but because your investment will be in U.S. or Canadian dollars, currency trends are important and cannot be ignored in your evaluation of the risk of an international insurance direct marketing business.

One solution to the currency problem is to buy futures. But since insurance is a long term business and futures are only short term (usually under 12 months), this solution won't work. If your company has funds in foreign currencies and is willing to live with keeping such accounts, then you really don't have a problem. Another option might be to avoid marketing investments and only operate on an insurance risk basis.

Language is another barrier which we confront when doing international direct marketing. Even though many insurance people for whom English is not their native language have fluency in, it is much better if you can converse in the language of the country in which you'll be doing business. Foreign language fluency is particularly useful if you want to construct products and brochures directly from the idiomatic language of the country in which the insurance will be marketed, rather than first construct them in English and then have a third party translate them into the local language.

Foreign insurance laws are different from those in the U.S. and Canada. As a broad generalization, the laws are not as detailed as in the U.S. or Canada. In one sense, it is like working in direct marketing about 20 years ago when response rates were high and regulations were minimal. It is always nice when you're developing a new product.

That was the good news. Because there is often a lack of a developed insurance direct marketing business, it can be difficult to get lawyers and company executives to agree on what is required to complete policies, marketing materials, administration and all of the other aspects of an insurance direct marketing program. It requires a good "buck stopper" executive to shepherd through an insurance direct marketing program without the uncertainties I've seen in a couple of cases.

When developing products for many countries, an actuary often discovers that the statistics needed to determine mortality or morbidity costs don't exist. This problem becomes exaggerated if the actuary is trying to read local publications while constantly looking up each word in his or her pocket size English/local language dictionary.

When I've been faced with developing new products without reliable statistics, I resort to either using U.S. data without adjustment, or trying to modify U.S. data to the country's apparent relative mortality or morbidity to the experience in the U.S. I've noted that experience in many European or westernized countries is not all that dissimilar from U.S. experience, and the approach I've just described will serve as a beginning point.

MR. H. NEIL LUND: The insurance marketplace in Europe is changing. Europe will potentially become a market to rival the U.S. in size. The intent of these changes, often referred to as "Europe 1992," is to permit free trade and free access within the European Economic Community for all products. For my portion of this panel, I'm going to briefly examine the European market.

It's fair to ask at this point why I am interested in Europe 1992. I personally have two reasons for that. First of all, the company that I am employed by is owned by a Dutch insurer. The strategies of our parent company influence the strategies of my company, and their strategy right now is strongly linked to the changes that will be taking place in Europe in 1992. In fact, I am indebted to Mr. Jaap Peters, Chairman of the Board of Aegon, as well as Mr. Jaap van der Starre, Corporate Actuary of Aegon, for much of the material that I used in researching this.

The second reason is that the changing face of Europe creates more than a market of similar size to that of the United States. It represents more than a parallel market to ours. It represents the increased internationalization of the insurance market. It represents the fact that we can no longer concentrate our efforts solely on the United States without consideration of what's going on in the rest of the world.

Turning to the broader scope, the concept of a united Europe is old. Politicians seemingly forever have spoken on unity. Wars have been fought over the unification of Europe. It is not a new concept. The 1957 Treaty of Rome laid forth the promise of an economically unified Europe and yet for more than 30 years, progress towards this has been slow. With a push coming from significant manufacturing concerns, such as Phillips, 1992 has become a focal point of bringing down many of the restrictions between the European countries. An example of some of the freedoms that are expected to take place after 1992 is that manufacturing concerns will be able to manufacture products in any one EEC country, eliminating the current need of having to have separate manufacturing facilities in several countries so as to avoid tariffs. They will be able to market freely within all countries. They will be able to transport their goods freely between all countries. Currently in Europe, a truck loaded with goods manufactured in, say, The Netherlands to be delivered in Portugal, would be stopped and have detailed documents filed at the Belgium, French, Spanish, and Portuguese borders. In fact, the paperwork is so onerous, that it is estimated that the average international truck in Europe averages only 20 miles an hour. This is a far cry from being able to zip goods, say, from a manufacturing company in Massachusetts, to deliver in Maryland, with relatively few impediments in between.

Within the insurance world, the goal is to allow an insurer domiciled in any one country to be able to freely market its products in any other country within the economic community. However, this is a formidable task. To give you some idea of how formidable this task is, we can examine several basic thoughts. First of all, let's look at the relative marketplace as they exist today. Six states -- France, Greece, Ireland, Italy, Portugal, and Spain -- currently prohibit direct insurance of risks in their territory by insurers not authorized and established there. This is an extremely restrictive situation.

Three states -- Denmark, Germany, and Luxembourg -- permit the customer to deal with a foreign insurer, but place significant restrictions on the ability to do so. One nation -- Belgium -- has few restrictions; while two states -- the Netherlands and the United Kingdom -- have a relatively free market.

Similarly, a review of regulation finds complete diversity among the 12 member countries. Some nations, such as Germany, regulate everything within the insurance market on a very direct basis. Some nations, such as Italy, exercise extensive controls; even some back door controls, such as the onerous practice of having to reinsure a significant portion of your business with the state at noncompetitive prices. Many of the nations, such as France, have the ability to control all aspects of the business; while only the Netherlands and the United Kingdom are truly competitive marketplaces, examining only the solvency of the companies involved and not imposing rate or compensation regulation.

We also find insurance is marketed differently in all European countries. General methods include salaried company employees, general agents, and brokers. Some countries, such as France and England, utilize all three. Other countries, such as Germany, have a predominance of direct sales force; the agents are tied specifically to one company, as is the case in Switzerland.

Additional impediments include culture and language differences. These are real impediments and perhaps the major obstacle.

So what we see is lack of homogeneity in Europe. Despite the promise of the Treaty of Rome, how is Europe ever going to develop a unified market?

What do we expect will happen? Basically, from the technical side, between now and 1992, the EEC will put forth a series of directives. The intent of the directives will be to have the host country define a set of rules and regulations that spell out the terms under which foreign carriers come in and write business. While not a trivial task, this will be a major step towards a truly open market. However, logistically we can expect a fair amount of protectionism that will only fall away with time.

Can foreign insurance companies succeed in selling outside their cultural home base after 1992? Yes, if they offer better products, better service, or have a better cost structure. No, because at least for the near term, regulations will essentially remain with the host country and because of cultural and language barriers.

In other words, don't look for miraculous changes. It certainly won't be easy to create this European market. But such a market will be created. Today we see four strategies being used by insurers to prepare for the changes:

1. Retrenchment. Becoming so dominant in your own market that foreign competition will face a very difficult fight.

2. Buying positions in other European markets. That is, either buy smaller companies already established or form joint ventures with others so that the local market can be entered with a local company.

3. Internationalization. Acquiring or forming ventures with both American and Asian insurers thereby not being dependent upon any one market and being able to "ride out" turbulence in any one market.

4. Looking for niches. Being able to bring superior product, service, and cost to a narrowly targeted market, an area where direct marketing techniques may be particularly suited.

Many companies, such as Allianz, appear to be utilizing all four approaches. A few appear to be doing nothing. In any case, strategies are being played out by European insurers.

By being permitted to market in other countries, over the long term, successful marketing strategies will lead to a common insurance marketplace.

In conclusion, 1992 does not look like it will be a revolutionary year for European insurance. Many barriers will remain. However, we can view 1992 as the focal point for an evolutionary change in Europe. A change that has started and will continue well into the future. A change that will mean the gradual removal of impediments in Europe. A change that will be driven not by politicians but by marketing.

MR. ROBERT O. DAVIS: On the 1992 situation that Neil talked about in Europe, we certainly support his position on that; and I guess our countries' barriers will go up between the United States and Europe. Our organization is now positioned in our London office to start to establish this type of operation, looking toward 1992 and the potential of doing business in Europe. We also have offices in Tokyo, and today we are going to wander through Southeast Asia. I'm going to bring you up-to-date on what's going on.

Global direct marketing is a fact and is not something that is in the future. I keep hearing people say direct marketing on a global scale is the wave of the future. Believe me, the wave is here. There is nowhere that you can go in the world that there isn't somebody doing direct marketing in some way, shape or form. I'm shocked by the amount of activity. When I started with AIG 10 or 12 years ago, I was running around the world doing programs where God himself wouldn't go, and we ran programs in 38 countries. There are at least 38 countries that I know of that are doing some form of direct marketing.

That leads me to a statement that I dreamed up one day while I was preparing a speech for another group, and that is that the past is for those who are willing to live in it. The future is for those who have the inspiration to build on the past, and now they have the will to start over again. What we see here is that the U.S. market has become so regulated and so difficult to operate in, it is no wonder our response rates and our products have stagnated here. I find the action is overseas.

Some of the products that we are able to develop over there, hopefully, we are going to bring back here. As a matter of fact, we are starting to do that already, introduce them to some of our clients. It is not easy getting a product approved here. I can run three or four products in Hong Kong in any way, shape or form. Just to give you an example, we ran a product over in Hong Kong where the benefits were payable either in U.S. dollars or in gold tails, and you had your choice of how you would like to have the payment made. In that market, obviously, the gold choice went like crazy. It was a terrific program. I am probably the only one in this room who is not an actuary or an underwriter, but a pure bred marketing man. And, as the music man said, "I'm mighty proud to be one." We work with both reinsurers as well as actuaries to bring to the marketplace products which we believe are unique.

Because of our extensive background in direct marketing in these 38 countries that we have operated in, we often take a product which has worked one place and adapt it to another. An example of this, which is one of the most popular and successful direct mail products offered to a list of one's own policyholders, is Birthday Life, which I'm sure you are all aware of. The concept is to offer life insurance prior to one's birthday with the persuasiveness of the fact that the client is getting older and now is the time to buy cheaper. We found this approach to have worldwide acceptance. We ran this product via direct mail in Kenya, and the response levels there were absolutely phenomenal. One of the funny things was that we never got any money back via the mail. They all brought their payment to the office, so we had long lines of people winding down the streets of Nairobi waiting to pay their premium. But the solicitation was done by direct response with traditional direct response methods. We even ran a computer letter. This program has also been run in Hong Kong, Australia, New Zealand, France, the United Kingdom, Japan, Taiwan, Korea, Italy, and Greece, all with the same general results. I can almost pick the response levels and tell you that within 3 to 5%, that is what you are going to get. It holds up in each one of these nations.

Basically, the concept is sound, and when the concept is sound, it crosses the lines because the need is there. When the concept is faulty, or it runs into a cultural barrier, obviously you are going to have some difficulties. But if you can come up with this type of a universal approach product, then you really have something running for yourself. Even though we have language difficulties, if one can understand the marketing conditions and the needs, you can have an adequate delivery system of some type in place. You can make most programs work. It's important not to give in because your approach does not fit the mold or the expectations. During the last five years, I lived and worked in Japan. I built a direct response company from the ground up in Japan. We started out with people who knew nothing about the business; and believe me, if I gave up at the first resistance barrier, I would have been back here five years ago. It took a tremendous effort just to keep our head up, because the government regulations in Southeast Asia, country-by-country are difficult. Sometimes you hit freewheeling countries, sometimes you hit countries that are extremely restrictive in what you can offer. Japan is one of those markets. We are going to run through the countries and I will end up with Japan, to give you some idea of what we are up against.

We have offered products where there is absolutely no need for them, and they have had some success -- like offering hospital cash to completely socialized medicine countries -- and have been able to make it work. The trick here is the positioning of the product.

We rely heavily on modeling. When faced with a skeptical client, we find that a very comprehensive model -- which contains the marketing cost, premium payment modes, collection methods, loss ratios, overhead assumptions, persistency, as well as a raft of other factors -- is very powerful. When the clients are allowed to change the figures so that they can feel comfortable, we find that it puts the weight directly on their shoulders regarding whether they want to do the program or not. We do run the program on Lotus, also. Most of the systems out there do run on U.S. based codes, so we don't have much difficulty in running our Lotus model. We also have our models run in multiple currencies, so we are able to switch the numbers around; and you have to have enough fields there to handle all the O's and yen, because you have to have those for Italy and lira.

What makes it all work is that you have some experience in predicting what the outcome is going to be, what the response levels are going to be and what the packaging costs are going to be. You have got to be clever in Japan, where we had a very bad postage situation for some years. We used to print in Hong Kong and ship the material to Tokyo to mail it out. It was cheaper to do that, than to print it in Tokyo. You have got to be fairly flexible in your thinking. I honestly believe you can make anything work if you just take a little time, a little effort, and are persistent.

We try to build a product that not only has acceptability by the target audience, but is also able to produce a profit when plugged into the model. Incidentally, this model also has GAAPing techniques. Everyone figures GAAP out differently, and it's not a technique that is well known outside of the United States, particularly in Southeast Asia.

I thought in this brief period of time I would give you a run-through of the countries in Southeast Asia in which I am currently involved. I will do a few of the more interesting places. I am going to skip over those that have little or no current interest, and will probably skip over the Philippines because of the political upheaval, even though we had terrific results in the Philippines. I am not going to touch on New Zealand and Australia, because I won't consider those to be in Southeast Asia for this discussion.

One last note as we go on this country-by-country synopsis, and that is that if it has less stringent regulatory bodies, it's easier in many respects to develop products outside of the United States, test them, and then extrapolate the results into a meaningful product here in this market. I'm working with a couple of consulting actuaries to do that right now: developing the actuarial data to bring a product in that we know has worked in one of our other countries.

We also believe in building strong relationships through database building and usage in many countries, where little work is done to utilize the database concept. The ability to build on your customer relationship and to grow your business geometrically is just beginning to gain acceptance. In many cases our role is that of a teacher rather than a marketer, since the concept of how one customer can influence another or lead to another sale is a new one. This naturally leads into building data systems to support that marketing philosophy. It is an area that we are probably the least skilled in, but we are learning and growing with it very quickly. All the countries I am going to mention have little or no database marketing to-date. There are a few that are beginning, and quite naturally, we find them to be in both Japan and Hong Kong.

TAIWAN

Let's begin with Taiwan. Taiwan is just beginning to open its doors to outside insurers. Several companies have applied for life licenses. It is very difficult to get one and they will most likely follow Japan's lead in that all of the pricing will be tariff rated. The tendency is to tightly control the market as well as investment opportunities, but recently it's beginning to open its doors as a reaction to the world pressure concerning trade.

Life insurance is becoming an interesting marketplace as an awareness of the need to pass on wealth becomes important. Taiwan probably has the fastest growing economy in the world today. The current marketplace is extremely young and it is driven by an extensive agency network which is both well trained and aggressive for the Taiwanese.

It is going to become difficult to get in and build an agency network. I understand New York Life is just entering into that market now. They have gotten a license in Taiwan recently, and they are going to have to start building an agency network because to get in via direct marketing at the present time is difficult. There is little credit card acceptance. There are no lists to speak of; but again, this is changing. The market is changing, and in another two or three years, we may have a whole different ball game.

KOREA

Korea is much the same as Taiwan. It has recently (1987) opened its doors to foreign life companies. It did it quite reluctantly. There was a filing of a 301 Unfair Trade Practices by the U.S. government on behalf of AIG, and that helped to open the doors. At the present, three companies are licensed with another five or six waiting for approval.

Nonlife insurance organizations, particularly those selling auto, have been in Korea for some time. Most of them developed businesses dealing with the U.S. military and branched out from there, trying to capture part of the Korean market; but the loss ratios are extremely high. Most companies are losing money because of some of the highest auto accident rates in the world. The Koreans tend to buy from Korean companies and foreign insurers, even Korean agents have found it difficult to break the barrier. It's going to be interesting to see how all these new life companies from the U.S. fare within the next few years.

Again, direct marketing is beginning to take some focus. There is a developing credit card market in Korea. We have been approached by several companies likely to come over to see what can be done. I worked in Korea out of Japan during the past five years, and found it to be a market that is emerging. I think it's not there yet for the direct marketer, but it certainly will come of age, I think, in another year or two. There are even brokers now starting to collect data.

The biggest fear I have is in the anti-selection that comes through the direct response method. You have to be extremely difficult in your underwriting. The Korean philosophy is if I bought it, I ought to use it. They don't feel that they have gotten their dollar's worth unless they have got a claim in. You are going to have to be extremely careful.

HONG KONG
Of all the Southeast Asian countries, Hong Kong is the easiest market to work in, and it is the most fun. Little or no restrictions on products or investments are posed. Multicurrency products are sold on both the life and nonlife side. You can even offer products in gold, as I mentioned earlier. Loss ratios are very, very low.

Most plans are investment types because of the uncertainty of 1997. As you all know, that is when China is going to exert some influence on that market. What that influence is going to be -- your guess is as good as mine. I believe, personally, that it is not going to be nearly as bad as everyone thinks. Hong Kong is the gateway to the West, and to the West, investment possibilities for China. They are not going to tear that apart, and there is the chance of having that currency influx. I think on the other side of the coin, they are going to make it very, very difficult due to bureaucracy. I think we are going to find a new bureaucracy being built by the Chinese. I don't think, overall, Hong Kong will change its market philosophy and attitude. Anything which offers overseas investment is terrifically welcome.

Loss ratios for basic AD&D products run between 19 and 25%. There are not many places to go in Hong Kong and most people rely on public transportation. That is why the losses are so low.

The most popular life plans are whole life, particularly endowments. We are selling an awful lot of single premium annuity business. Anything that has got that investment that you can put offshore is a very popular product. There has been a movement toward term products because of the high face amounts, particularly if they are offered in U.S. currency. But the basic old line Chinese will still rely on is investment type products. They would rather, by nature, not face death since there is a heavy superstition about anything relating to it. They look for places to put their money to keep it away from the taxing authorities.

SINGAPORE
Perhaps the country which represents the best balance between the difficult tariff-rated nations and the free-wheeling Hong Kong market is Singapore. Products and rates must be approved, but no approval is withheld unless the product is blatantly illegal or unfair to the consumer. All types of products are sold and even though small in population (2,500,000 people), a great deal of both life and nonlife products are sold. There is a terrific middle class here with great needs -- a very wealthy country.

Investment in offshore currencies other than reinsurance is not allowed. This does not seem to affect the very stable Singapore market. One of the major drawbacks is the insistence of government getting into the insurance business. They continue to expand their role as more and more of the Provident Fund, (a form of social security which everyone pays into to guarantee their pensions) goes looking for investment potential. They always are finding new insurance plans in which to invest. Companies can basically make up their own rates, but must always be aware of the fact that the government may be offering a plan quite similar to what they are selling, and use that as a guideline.

JAPAN
We can probably spend the whole time here today just talking about the opportunities in Japan. First of all, if you are not in there, if you are a life company, it's probably a pretty good time now to get in. There is a lot of political pressure to get in.

The market is divided down the middle. You are either a life company or you are a nonlife company. You cannot be both. There are very few life companies. There are only, I think, to date 12 life companies, and there are something like 38 nonlife. It's easier to get a license on the nonlife side. The nonlife side covers such products as personal accident insurance, property and casualty. The life side handles the health side of the business and also all versions of life insurance of course. There is no such thing as an A&H product in Japan, because the accident is handled by one company and the life is handled by another. You can't even cross over in your systems. So, when you go in you have to make up your mind which side of the fence you want to be on. American Family, as you know, went in on the life side, developed a cancer product, which is a health product and only related to the health side, and now have more than $600 million worth of business. It is a tremendous, responsive, difficult country to operate in.

We don't need a lot of actuaries in Japan, and we don't need a lot of underwriters. Everything is tariff rated. You can pick up the book and read the rates, and you can sell them. The secret is in the packaging, particularly for the direct marketer. You must learn how -- to take what is offered, package it differently, add some different benefits where you can, and try to get through the government approval.

You can't do direct marketing without a direct marketing license. To obtain a direct marketing license, you have got to be a bonafide company with assets, you must be admitted, and you must send to the government the most comprehensive marketing plan and strategy that you have ever seen in your life. It has to handle how the backroom work will be done, how you will collect premiums, how much premium will be collected when, what your break even point is, what your reinsurance philosophy is.

If you can survive all of this, you've got a tremendous opportunity. The companies that have been in there for some years and are doing well now, such as AIG and Cigna, are really doing well. You must realize that most of them went in there with the yen at 3.80, and the yen today is 1.27. Just a change in the exchange ratio alone has made these extremely profitable companies.

We find that the systems side of the business lags well behind the United States. Database marketing is just beginning to be understood.

During the past five years, I served on a committee with the American Chamber of Commerce, and our job was to lower the postage rates. Everything was first class, and the equivalent was about 38 cents to mail a piece of postage. We got a significantly reduced advertising rate and now the postage rate is 30% lower so it only costs about 19 to 20 cents in order to mail a piece. So, it's making it at least possible to start to build a list business.

The product line is still a problem. Developing products that are unique and different takes a long time. We bring in statistics from the United States and get ourselves in a terrible, terrible loop. The Ministry of Finance (MOF) which approves all products wants to know all the data about a product and then when you bring in all the data they say, "Yes, but Japan's different. That doesn't relate to the Japanese market." We say, "Well, why did you want us to bring in all this information?" Well, we have to have some supporting documentation. You just go round-and-round, and that can go on for quite some time. I would say it took between a year to two years to get a new product approved, a truly unique product.

So there is the picture of Southeast Asia. It is frustrating in some respects, with wonderful opportunities in other respects. We think it's the place to be in the 1990s and we know the international market is the place to be in the 1990s.

MR. BRUCE D. BARTON: The first question you are probably asking yourself, and I asked myself when I was asked to participate in the Panel Discussion, is what is the role of reinsurance in direct marketed business? Direct marketing usually involves the sale of a large number of small policies, whereas reinsurance is usually involved with a small number of large policies. But, reinsurance does play a large role for a lot of companies and their direct marketing business. In fact, Lincoln itself is involved in a unique international arrangement which I will talk a little bit about in a few minutes.

What I need to do is give you a little bit of background about why companies reinsure business, first of all, and then why you would want to reinsure direct marketed or direct response business. After I've done that (and hopefully convinced you that there is a role for reinsurance in a more traditional reinsurance view), then I will also make a few comments about the unique arrangement that Lincoln is involved in which might give you an idea of how some companies are using reinsurance to really enhance what they are trying to do in the direct response area.

First of all, then, why do companies reinsure business to start with? Traditionally, as I mentioned, reinsurance is thought of as helping companies with a small number of large policies that would be above their retention, that would expose their companies to an unusual risk or a larger risk than companies are willing to take in any one instance. Basically, what reinsurance has done, then, is provide coverage for that excess amount of risk and also, depending upon the type of reinsurance approach used, provides some sharing in the mortality and lapse risk that companies have been undertaking.

That is not all the risk that a direct company has. A direct company has mortality and lapse risk in the products they write, if you are talking specifically about life products, for example, but, they also have other risks. They have marketing risks; they have expense risks, if it is some kind of savings or investment product (as Bob mentioned), which is popular in a lot of international markets. There is investment risk. As Jay mentioned, there is foreign currency risk.

Traditionally, reinsurance, particularly life reinsurance, has been structured more towards sharing of mortality and lapse risk. Supplementing this traditional excess risk though, there have been a few other reasons for considering reinsurance that companies have used in the past. Relief from surplus strain for small companies or companies who are not surplus rich, or help with cash flow or cash relief have often been reasons for considering reinsurance. These goals can be accomplished either through a special structure to the reinsurance arrangement or by perhaps reinsuring more of the business than you might otherwise. You might reinsure have of a given product if that product had a lot of surplus strain; for example, some type of an investment product which develops surplus strain. You might reinsure more of that product than you would on a traditional excess basis. Another, more financially related reason to reinsure, is that some companies have been able, depending upon how they price their product, to leverage the return on investment that they are getting on their retained business by reinsuring a portion of that business. Provided the reinsurer's expenses or their profit margin, or perhaps their understanding of the assumptions, give them the ability to price the product more aggressively; which allows a company to retain a smaller amount of business but enhance its return on that portion.

More recently though, there is an emerging group of reasons for purchasing reinsurance that aren't so much related to the traditional excess reasons or even some of these more complicated financial reasons. I'll call those the partnership reasons. These, I think, have a lot of applicability in the reinsurance of direct response or direct marketing business. First of all, there is access to expertise by involving a reinsurer or by involving a consultant. The market is so complicated that companies today find it much more difficult, whether you're operating internationally or whether you're operating even interstate within the United States. It's much more difficult for companies to operate alone today. More and more companies are using consultants, or using their reinsurer as a form of consultant, to help them price their products, underwrite their products, design their products, or market their products. I think today, more and more companies are looking for a means of getting additional expertise to address their particular problems and situations. Just to give you an example, and not a direct response example, but a typical example that would come up for a reinsurer:

> Take a company that is in the universal life marketplace already and would like to move into a related market such as group universal life. They have questions about mortality assumptions for those kinds of products. Underwriting in those situations. What is guaranteed issue? How do you use that? What is simplified issue? How does that differ from traditionally underwritten products and so forth.

A reinsurer has kind of a window on the marketplace, sees what other companies are doing, has participated in that kind of business and can give their client additional expertise to address that particular situation. It allows a company to move into the market more quickly than they might be able to otherwise. A consultant could play a very similar role. Some companies today are networking with other companies that are similar, and there are lots of associations. Direct marketing associations are getting much more popular. Jay mentioned a couple of additional associations and councils that are being formed. So, some type of access to additional expertise is an additional reason for considering reinsurance of a product.

Another reason is an increased capacity to write business. If you are working with products and trying to develop assumptions and price products and test them for profitability, every actuary knows you like to have the law of large numbers working in your favor, and this is particularly true in the direct response business. You want the law of large numbers working in your favor. A lot of companies on their own don't have the capacity, either because of budgeting constraints or surplus constraints, to write as much business as they would like -- to get the law of large numbers working in their favor. Involving a reinsurer can increase the companies' capacity to write business, particularly in international markets. But, it is also true domestically.

Companies can benefit by involving a partner, in terms of developing credibility within the marketplace. If you are going to operate internationally, you are going to have to possess some credibility in that marketplace. Your own company may not bring that credibility to the marketplace, but through involvement with a reinsurer, you may be able to get that.

Those are some of the traditional reasons and some of the newer more emerging reasons why companies consider reinsurance. The driving impetus in reinsuring direct response business is not to cover excess amounts of large policies. Mostly the size of the policy -- whether it's a property/casualty product or a life product or a health product or an accident product -- the size of the products is not a driving force. Lapse and mortality coverage, sharing in those risks is important, but not as important as is covering the marketing risk. Those of you who have been involved in pricing direct response products know that although there is lapse risk and mortality risk or morbidity risk, those are not the primary factors which can affect the profitability of your product. In many instances, the primary factor is the market risk, what response rate you are going to get, how costly it's going to be to get the product to the marketplace. Bob mentioned trying to control those costs by working in Hong Kong and in shipping products to Japan. The marketing risk in this business is one of the primary concerns, and the sharing of that risk can be, and probably should be, an important consideration for a lot of companies in choosing a reinsurance avenue.

Cash flow relief and statutory strain relief can be important also. Again, to get the law of large numbers working for you, involving a reinsurance partner can add to your capacity to write business. I think those are particularly applicable in direct response. Having access to expertise, the increased capacity to write business, and credibility are helpful if you are in an international market. If you are a U.S. company and you want a market in Switzerland, for example, if the Swiss Re is your reinsurance partner in Switzerland, you would have immediate credibility -- in that marketplace. Operating with any international reinsurer or local company reinsurer is going to add credibility to your efforts. It's going to be very difficult to take a U.S. operation which doesn't already have international components to it, and do much in the international marketplace, unless you involve someone who has that expertise.

So, given there are some reasons to reinsure your direct response business, how would you go about doing it, and what's similar about it and what's different from traditional reinsurance approaches. First, it would generally involve a quota share of the business. It would involve a portion of the business, not an excess amount of the business or an excess above a company's retention. Generally, we have done it in a co-insurance fashion (not a YRT approach) which would provide a sharing of all the risk, would allow for sharing in the marketing risk, the mortality risk or morbidity risk, and the lapse risk. Co-insurance generally is a more flexible avenue to allow the reinsurer to assist the company in accomplishing its other reasons for reinsurance.

Beyond those components though, reinsuring a direct response business departs from traditional reinsurance. There isn't a traditional automatic relationship or facultative relationship such as you have in the life and health business. Generally, the direct response reinsurance arrangement from here on takes on more the nature of a joint venture. The reinsurer is usually involved in the product pricing. It is involved in evaluating and analyzing the marketing approach. It's involved in the expense assumptions and how much is going to be spent on printing and mailing. What are the marketing expenses that are going to be involved up front? What is the anticipated response rate? If the reinsurer is going to share in the marketing risk beyond the traditional morbidity, mortality and lapse risk, then it's going to want to be involved in designing the product at the beginning and evaluating the market and evaluating the potential response rates and in having some influence in the design of the whole program.

Let me turn now and just talk a little bit in my closing couple of minutes about a venture that Lincoln National is involved in, which uses reinsurance of direct response business as its foundation. We became involved (three or four years ago now) in an effort with another reinsurer and with a direct response direct mail advertising agency, in forming what I will call a consulting firm -- although that's not exactly what it is -- but a firm called Reinsurers' Marketing. The concept behind this was to develop international direct response business. Reinsurers' Marketing, with the expertise and the financial support of the reinsurers and this direct mail advertising agency behind it, approaches insurance companies or list holders potentially in international markets. It offers to help them get into the direct response business if they aren't already into it, or if they are, offers to help them expand their capacity to write business or their expertise in writing business. In exchange for that, it helps finance the business and reinsures a portion of the business. That venture is operational. It's operating in Europe now and the Far East, Canada, and Australia. It has been for us a really enlightening and rewarding experience. For the companies that are involved, it has allowed them to get into the direct response business with a partner who has expertise and with a partner who has capacity to assist them in doing it in a big way, so that they can get the law of large numbers and develop a broad spread of risk and get into the business faster than they could on their own. I will conclude my remarks so we have a few minutes for questions.

MR. PAUL A. CAMPBELL: I would like to add just a couple of minutes of commentary to what has been spoken on. In my 15 years of international consulting, I think we can say that there have been certain facts of life that haven't changed in that period of time. Number 1, that the insurance business has definitely been an international business. It just happens it's been lead by the Japanese, the Germans and the Dutch, who have in many instances had their representatives become some of the largest companies in the world; whereas in the United States, that interest in international business has been definitely cyclic depending on certain environmental and economic factors that have made it go up and down. The corresponding thing that has been a lack of consistent corporate strategic planning leading into these kinds of activities. Finally, I would say that the actuaries in the United States have been much less involved in international management than actuaries in other countries. This may be seen by the number of people that are at the session, and I think that is a reflection of the fact that we similarly haven't convinced ourselves of how important it is for actuaries to be involved. Recently, of course, the foreign companies have stepped up the tempo; but it's been on a very intelligent basis. What is going on in Europe is a very strategically oriented building of relationships between companies. The U.S. companies are still doing things on somewhat of a first-come first-serve basis, country by country. To pick up on a word that Jay has mentioned, transactional management is probably the best thing to think about in terms of international management and getting into the direct marketing, recognizing that differences are going to exist country by country, but making those differences exist within an overall corporate plan that makes it sensible to get into Taiwan or Hong Kong and some of the other places so far away.

MS. AMY HELEN COLEGLAZIER: I've got a question for Bob Davis. Since the databases are not developed in a lot of countries that you are in and you are using a birthday life approach for which, obviously, you need a birthday or at least age, what are you doing?

MR. DAVIS: Good question. What we basically have done is to go into a country that has a list of clients or a list of customers already, and try to data input all of that file. One of the biggest damagers that you run into is somebody starts a business and has 100,000 customers, and then you say, well now let's put these into database format -- and suddenly they're faced with a huge data input bill on a system that is incapable of handling them. So we have been fortunate, particularly in those countries where I ran the birthday life programs. Most of those have had a customer list that has been relatively small, and we could bring it up and data input it and show how it worked, and then build the system off of that. We build data systems off the smallest possible unit that you can get into. If it is an AT that you start with, or a small personal computer of some kind, we put it up and then we spin it off to such things as a system 36 or back-up to the mainframe depending on the size. We have got more than a million records in Japan now with a company that put together data files running on a 36. It means you have to do a lot of downloading and you can't use all of the records at a time, but they're ready for mainframe capacity now and that is a very valuable file.

When you have that situation, find a product where you get a tremendous response rate and build your database. You can kill two birds with one stone, so to speak.

MR. DESAI: To add to that, in a country which has a good database, we use a birthday sweepstake approach which a lot of people are interested in because of their birthdays. It's the race to go around them, if they read.

MR. WALTER SHUR: Bob mentioned that we had a license in Taiwan. You may have more up to date information than I have, it's entirely possible. I know we have made application for a license in Taiwan and I don't think that we have a license. We have almost concluded an arrangement in Hong Kong for a purchasing general agent there. I came in a little late in the session -- did anyone talk about taxes at all? Income taxes on the companies, how that's working, whether they are consolidated with the U.S. and so on.

MR. LUND: I don't think there is a clear cut answer to your question. We work mostly in Europe and our parent is located in Europe. We structure things so that we take advantage of whatever tax situations we can. That means we've got some things that are consolidated for tax purposes and some things that are not consolidated. I believe we have three separate tax entities in the United States, rather than one. Tax strategy is an important consideration, but it's going to depend on your structure and where you are and what the structures of the companies are that you've got, and if you have nonlife entities or noninsurance entities. It's beyond the scope of this meeting.

MR. DAVIS: It was my understanding that you were very close to getting your license, and the last I heard was that you had received it, but apparently that is not correct information. I know about your Hong Kong situation, but didn't want to talk about that. The tax situation, as far as I know with AIG, was handled by an awful lot of reinsurance offshore. It's an extremely complex matter.

FROM THE FLOOR: I was interested in to what extent the trends and social insurance programs are either creating more or less opportunities for supplemental insurance, such as medicare supplement insurance in the states here -- do you specifically target supplementing with state programs, or is it more of a general sort of offer.

MR. DAVIS: I'm sure that anyone who has worked in the U.K. market for some time knows that they have been selling hospital indemnity products for a great number of years. I started out with a joint venture with National Liberty; in the early 1970s, we sold it over there. The supplemental product market is there. In Japan, as a matter of fact, it's a very large market with what they call the FIH product, or Full In-Hospital, which is nothing more than a hospital indemnity product. You're back to the same basic philosophical opportunity that Birthday Life gives you. You have got the need the greed. If the need isn't there, perhaps the greed is there to get that cash in your pocket to use anyway you want while you're recuperating. There always will be that supplemental market there, even though we are selling broad based products, we are also selling a lot of the supplemental products that you are selling here.

MR. DESAI: You had a follow-up question?

FROM THE FLOOR: Yes, I think you answered my question. I was sort of interested in whether the trend was towards more comprehensive government benefits or pulling back.

MR. DESAI: Most of Europe is going more towards right, if you will, and there is a trend to cut the budgets down. In the U.K., for example, there is a severe medical crisis in terms of what is available through socialized medicine. A lot of people are buying supplemental insurance that enables you to go to private doctors and private clinics. There is more need of that. Some other trends are towards more deductibles, and so on. It depends on the country.

MR. DAVIS: Just a very quick comment about socialization. If you've looked at the demographic statistics of the world you've seen that there is aging in almost every major nation or every major country that we do business with; Japanese have the fastest aging population in the world. Because of that, governments are finding it more and more difficult to provide benefits for that society. It takes many people to keep the benefits going into a social security system, even now in the United States. I would say that the trend is more towards people paying their own way, with less government involvement, only because of the huge bill that it takes to sustain that.

MR. CAMPBELL: Let me just set the record straight as far as Taiwan is concerned. Under pressure from the Department of Commerce, the Taiwanese government agreed to open two licenses for life companies in 1988 and two licenses for PC companies. I believe it was Life of Georgia, a subsidiary of National Nederlande and Metropolitan that got those two licenses. The Department of Commerce is still working to see whether or not they can set that as a pattern in 1989 and years after. They are still not certain about that.

MR. DESAI: Thank you, Paul. I think we are running over the time. I share Paul's initial comment that it's a shame that we only could share the knowledge of a few, but quality is sometimes more important than quantity and with that, I thank you all for coming and I thank the panel.