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RESPONDING TO THE MARKETPLACE OF THE 1990s

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MR. ALLAN D. AFFLECK: A major theme of this meeting is life insurance product development. Our keynote speaker for the meeting, Walt Zultowski, will set the stage for our follow-up sessions by presenting his views on marketing trends in today's environment. Walter H. Zultowski, Ph.D. is Senior Vice President, Research Operations, for LIMRA International. He directs the staff of one of the country's most respected research organizations. Walt joined LIMRA as an associate scientist in the consumer research unit in 1978. He has designed and conducted several projects including an analysis of the public's response to the broadened availability of individual retirement accounts in 1982. He also co-authored a chapter in the book *Personal Selling: Theory, Research and Practice*. His talent lies in distilling LIMRA's wealth of research information into useful terms, making him a highly regarded voice in the financial services marketing field. He is heavily involved in various industry committees.

DR. WALTER H. ZULTOWSKI: As Allan mentioned I represent the Life Insurance Marketing and Research Association (LIMRA) based in Farmington, Connecticut. I'm sure that most of you have run across LIMRA at some time or other in your careers, but I also suspect that many of you are not aware of the extent of our activities. We are, of course, a life insurance trade association -- representing some 325 companies in North America, along with several hundred other companies around the remainder of the world. In the world of trade associations, however, we are unique. Unlike most associations, we're not involved in lobbying or public relations. Rather, our mission is to serve as the research arm of the insurance business. We're perhaps best known for our human resources and selection research, and in the form of the career profile system, we market what is probably the most extensively researched and validated personnel selection instrument in the world. Another hallmark of LIMRA has been our ongoing work in the monitoring of industry performance measures -- an activity which has earned us the title, "score-keeper of the industry." We also have extensive market and consumer research programs, and also conduct research relating to compensation practices and the financial management of insurance agency operations. Some of this research goes back to the early 1920s, and many of these studies are conducted on a periodic basis for trending purposes. So, when we mix this knowledge base together with the regular contact that we have with many companies' executives from all around the globe, we feel that we have a pretty good formula for understanding what's happening in all corners of the life insurance marketplace.

The title for my presentation is, "Responding to the Marketplace of the 1990s." I think you'll agree that this is a very timely topic as we approach the last decade of this century.

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I also hope that when I'm finished, you'll perhaps agree with my belief that we may well be on the verge of a decade of very significant change for the industry -- a decade which, in retrospect, may make the turbulent 1980s look like a mere warm-up exercise. I will focus on changes that we might experience in the areas of product and distribution during the upcoming decade.

Before getting into the heart of that, however, it will be useful for us to review some statistics as to where we stand as an industry today in these two areas. This will serve not only as a "mental warm-up" for us, but will also form the basis for some of my later comments.

First of all, in terms of individual life sales results, 1989 showed results that were down 2% over the period to 1988, and this is the second year in a row of negative numbers in this area. Now, if we look at sales on a policy measure basis, the number is down 5%, and this has been a negative number really since about 1982 in our business. Now, I know that some of you are thinking, could that be due to the fact that with universal life we now have policies that can get add-ons into the business as opposed to writing a new policy? And we've taken a look at that, and that doesn't seem to be the factor affecting these results. I think there are some more basic things going on that I'll share with you soon.

And, finally, when we look at the first quarter of 1990 we can see we were off to a better start this year, and this seems to be primarily attributable to the fact that the last half of last year saw some significant recruiting activity in our business. One of the things that our research has shown is that one of the best predictors of sales, at least on a short-term basis, is recruiting activities about a half a year earlier, really not very surprising, and we see that lag in the data certainly coming through in the first quarter results for this year.

Well, so much for how much we've been selling. What have we been selling? (See Table 1.) Here you see the individual life sales mix numbers on an annualized premium basis for last year and also trending it back to the early part of the decade. What you see in 1989 was essentially that there was virtually no change in the mix of business that we were selling compared to 1988 and really 1987, for that matter, In fact, this has caused some observers in our industry to comment that really the product revolution is over in the business, and we'll have a lot more to say about that soon.

TABLE 1

Life Product Sales Mix (Annualized Premium in Percentages)

	1981	1983	1985	1987	1989
Whole Life*	78	65	47	51	53
Universal	2	18	38	27	27
Variable	1	2	3	3	1
Variable-Universal	--	--	1	7	6
Term	19	15	11	12	13

* Includes Interest-Sensitive Whole Life.

But we also see the history of the product sales activity of the decade. See universal life peaking in 1985 and then falling back off through the remainder of the decade. See whole life products, including interest-sensitive whole life products, really going in virtually an opposite direction, being at a low point in 1985 and then coming back a little bit stronger as we ended the decade. And we also see the slow growth of registered products -- the variable and variable universal life (UL) products that were coming on in the mid-1980s -- essentially falling off, being largely attributed to the stock market crash in October 1987.

Well, I mentioned recruiting. What has our industry seen in terms of recruiting results? In Table 2 you see the numbers basically going back to the early 1980s, and really these numbers should be no surprise to anybody who would consider themselves to be a student of the industry. We saw in the early part of the decade that recruiting was off quite a bit, largely as many companies were questioning the agency system, wondering about alternative distribution systems and the like, and we've now seen in the later part of the decade that the situation has come back a little bit, and, if nothing else, perhaps it's at least stabilized somewhat.

TABLE 2

Recruiting Trends
(Shown in Percentages)

1981	- 7
1983	- 5
1985	0
1987	+ 1
1989	- 2
1st Quarter 1990	0

Now, the question we always get asked at LIMRA is, how many agents are there out there? (See Table 3.) And this issue of the exclusive agents in the distribution system is a tough one to get a handle on. In today's environment it's tough to really define what an exclusive agent is. My favorite definition is probably a pretty good one. An agent who's an exclusive agent attends fewer than five company conventions a year. But, nevertheless, we can tell when we consider an exclusive agent to be one who essentially places 75-80% of his business with his primary company.

TABLE 3

Number of Exclusive Agents

1973	253,000
1975	249,000
1981	244,000
1983	240,000
1986	240,000
1989	242,000

You can see that back in the early to mid-1980s we had the traditional 250,000 agents -- that number gets quoted all the time -- and that number fell off as we moved through the latter part of the 1970s. There was more dramatic fall-off as we went into the early and middle part of the 1980s but has now stabilized and perhaps come back a little bit.

Now, you may be asking a question which is really a very good one in that we know, as I said just a little while ago, that there's a relationship between recruiting and the agency force and sales activity. So, if it appears that the sales force has come back a little bit in terms of its numbers, why are we seeing such a lackluster picture in the sales results? Well, I think if we peel the data back a little bit, you get a good image as to what's happening. Table 4 takes a look at the percent of exclusive agents by distribution system. What you can see is that within that exclusive agent category most of the growth has been in the multiple line, exclusive agent category -- companies like State Farm, Nationwide and Allstate. We see ordinary has basically come back to where it was before on a mixed basis -- perhaps not quite there as it was in 1974 -- and we see a continued, rather dramatic fall-off in the number of home service agents. I suspect that this, more than anything else, perhaps, is the prime contributor to the number we saw before in terms of decline in the number of policies because, again, much of this distribution system is involved in marketing lots of policies, albeit somewhat of a smaller face amount.

TABLE 4

Percent of Exclusive Agents by Distribution System
(Shown in Percentages)

	1974	1984	1987	1989
Ordinary	50	47	46	49
Home Service	33	28	27	20
Multiple Line Exclusive Agent	17	25	27	31

Table 5 is market share of new premium by distribution system.

TABLE 5

Market Share of New Premium by Distribution System
(Shown in Percentages)

	1984	1987	1989*
Exclusive			
· Ordinary	42	38	40
· Home Service	15	13	10
· Multiple Line Exclusive Agent	5	5	7
Personal Producing General Agent	36	43	42
Direct Response	2	1	1

* Estimated

You can see, piecing together with the last result, that, yes, the multiple line segment has been growing, but as a group it tends to be much lower in terms of its production of new individual life premium. Certainly there are some companies within that distribution system, State Farm, for example, that are making great gains these days, great strides in terms of producing individual life business. I think that's a major factor in terms of the group that has been growing. Exclusive agents has been a group that's not the greatest producer of individual life business. We also see the PPGA and brokerage category which saw great growth during the product revolution years of the 1980s starting to slow down somewhat and maybe even fall off a little bit. And, interestingly, direct response, which we've heard a lot about, has never really accounted for more than about 1% or 2% of new industry production, and that trend continues.

But so much for where we are today. What changes does the upcoming decade hold in store for us, and what will be the driving force behind these changes? For me, the answer to this latter question is clear. The driving force for the 1990s will be that of the marketing principle. Taking you briefly back to undergraduate Marketing 101, you'll recall that the marketing principle states that consumers' wants and needs are formed and modified by a whole host of external environmental factors (e.g., demographics, the economy, societal attitudes, etc.). Successful businesses are the ones that respond by offering products/services that answer these needs, and distributing these products as efficiently and effectively as possible. Thus, marketing is simply the process whereby business anticipates and responds to changing external environmental factors as expressed through the changing wants and needs of the consuming public.

Moreover, there are three important corollaries of this principle:

1. The marketing principle works in the long run (whether we like it or not).

2. The marketing principle can result in *fundamental* or *structural* (i.e., relatively permanent, noncyclical) changes in a business.

3. We'd better recognize these changes and get out in front of them, or we'll be dragged along kicking and screaming (again, because the marketing principle works in the long run -- whether we like it or not).

Now, as you might have already guessed, I firmly believe that: the marketplace has been working like clockwork over the last decade or so in our business; the insurance industry is experiencing *structural* changes that have the potential of dramatically altering our business over the next decade; and many in our business don't recognize these changes that are occurring, or if they do, they'd rather look away in the hope that they'll go away.

As our industry emerges from the turbulent 1980s, there are two major lessons that we learned:

1. Our industry is not insulated from the marketing principle as many in our industry traditionally believed. In this regard I recall a story. I think it was the first LIMRA meeting I attended. I was right out of graduate school, and this grayhaired gentleman came up to me, and he said, "Son, now that you're in the insurance

business you can forget about all that marketing theory you learned in school because it really doesn't apply in our business because we're insulated from all that. You know, people die in good times as well as bad times, in periods of high economic inflation and interest rates as well as they do in periods of low economic inflation and interest rates. And, after all, our products are sold not bought anyway. So, really all that stuff doesn't apply to us." (One only has to look at the impact that the economy, consumerism, the government, and technology had on our business in the last ten years to appreciate this.)

2. Our industry followed fad instead of trend during the 1980s, and many companies today are trying hard to recover from the results of this error in judgment.

At the risk of getting into an argument over semantics, the fad was financial services and financial planning -- as much of the industry defined them (i.e., as tax avoidance and/or get-rich-quick schemes). Yet, while much of our activity was directed toward these areas in the 1980s, our industry tended to lose sight of the fact that the public had a host of continually-evolving financial *security* needs.

These are perhaps demonstrated in LIMRA's *Security Expenditures Study*. In this study we examine trends in total financial security spending by our society as they relate to the risks of dying too soon, becoming disabled, poor health, and living too long. First of all, it should be mentioned that spending for financial security has been growing, and we now estimate that some 33 cents of every dollar of disposable income goes to guard against these risks. Thus, we've clearly been in a growth business over the last couple of decades. (See Table 6.) However, we also see that there is a trend toward increasing growth in spending to guard against the risks associated with poor health and outliving assets in retirement. Here we see back in 1973 that it was about 68 cents out of every financial security dollar, and that jumped up to 79 cents in 1988. I suspect that number would have been even greater had not the individual retirement account regulations been changed, which was primarily responsible for the drop-off that you see in the lower right-hand corner of Table 6.

TABLE 6

Total Financial Security Spending
(Shown in Percentages)

	Life	Disability	Health	Retirement
1973	22	10	27	41
1976	19	10	28	43
1979	16	11	31	42
1982	14	10	34	42
1985	13	8	32	47
1988	13	8	36	43

Assuming that society does not have unlimited dollars to spend for financial security, changing consumer needs can only be accommodated through changing the "mix" of spending among these four risk categories. Thus, our society seems to be "voting with its dollars" and saying that the risks of poor health and outliving assets in retirement are becoming increasingly important -- more so than the risks associated with dying too soon and becoming disabled.

Since the 1970s we've also seen a trend toward faster growth from "private" spending sources (i.e., individual product purchases and/or spending done by an employer on behalf of individuals) in comparison to the "public" sources (i.e., spending through tax-supported programs). This trend reversed in the late 1980s (see Table 7) with the IRA shutdown. This is only temporary because with our government's current challenges relating to social security and the budget deficit, there would seem to be continued pressure for private sector spending to meet these financial security needs of the public.

TABLE 7

Source of Financial Security Spending
(Shown in Percentages)

	Public	Private
1973	61	39
1976	60	40
1979	60	40
1982	58	42
1985	58	42
1988	61	39

Returning to my marketing principle, it doesn't take a rocket scientist to recognize that these trends relative to concerns for health and retirement and long-term care will continue in the future -- demographics alone dictate this. For example:

-- People 100 years or older used to be a rare occurrence. Today we have over 20,000 centenarians in this country, and the number is really growing daily. Also, demographers talk about the old, old segment of the population as one of the fastest growing. A friend of mine once said, "Yeah, and if you want to target them as a market, they're easy to find. They're all watching Willard Scott in the morning, waiting for their pictures."

-- Shortly after the baby boomers start reaching retirement age, anywhere in the 2011-2020 period, the age distribution of this country will be the same as it is in the state of Florida today. So, if you kind of want an image as to what the future world is going to be looking like in which we're going to be living and working, think of the U.S. as one big St. Petersburg, and you really will have the picture.

Thus, concerns for retirement security, health, and long-term care can only grow. Moreover, continuing budget deficits will exert increasing pressure for these financial security needs to be met through private sector spending.

If you recall my basic tenet that the marketing principle works in the long run, it could well be said that our industry is, in fact, responding to these changes in the marketplace.

Look at Table 8, for example, at the shift that has occurred in the sources of company income by these three product categories over the last several decades.

TABLE 8

Company Income by Product
(Shown in Percentages)

	Life Insurance	Annuities	Health Insurance
1960	69	8	23
1965	65	9	26
1970	59	10	31
1975	50	17	33
1980	44	24	32
1985	38	35	27
1988	32	45	23

Recent industry product sales results also support this trend. (See Table 9.) As mentioned earlier, life sales have been very lackluster since the replacement era of the mid-1980s (with the exception of the single premium life anomaly in 1987).

TABLE 9

Individualized Life Sales Results
(Annualized Premium in Percentages)

1980	+ 8	1985	+ 15
1981	+ 15	1986	+ 1
1982	+ 4	1987	+ 10
1983	+ 25	1988	− 1
1984	+ 15	1989	− 2

Sales of annuities have been booming. (See Table 10.)

TABLE 10

Annuity Sales Results
(Shown in Percentages)

	Periodic	Single
1984	+ 8	+ 11
1985	+ 42	+ 28
1986	+ 38	+ 20
1987	+ 33	+ 40
1988	+ 26	+ 51

Sales of long-term care products are starting to come on strong in Table 11. I suspect that in the late 1980s single premium life business that went to annuities when single premium life was effectively shut down. Annuity sales have been just going wild, as have long-term care products.

TABLE 11

Long-Term Care Sales Results
(Shown in Percentages)

	1988	1989
Policies Sold	--	36
Companies Selling Long-Term Care	103	118
Employer Group Plans	11	118

Data from Health Insurance Association of America (HIAA).

Look at the number of policies sold, the number of companies selling long-term care (LTC), and also the number of group employer plans. The number of companies selling LTC is really a staggering one. And this doesn't even include the accelerated pay-out riders which, of course, is another approach to this whole long-term care area.

The challenge for many companies in our industry today, of course, is the fact that the products responding to these evolving financial security needs of the public don't carry the profit margins necessary to sustain an agency distribution system in the long run -- at least at the current industry levels of the economics of the distribution system (i.e., retention, persistency, productivity, unit costs). Also, the fact that the industry's newer life products that we went with in the 1980s carry lower profit margins contributes to this profitability challenge.

The response of many companies to this challenge today is one of "digging in their heels" and attempting to focus their agent activity on their most profitable product -- life insurance. This is reflected in the often heard comments today that "we're going back to basics" and/or "we are going to sell our way out of this profitability challenge."

This strategy, however, seems to fly in the face of what's happening in the marketplace, both in terms of external environmental trends and changing consumer attitudes.

As shown in Tables 12-14 we have a public whose attitude toward life insurance has become less positive over the last decade. Interestingly, however, it's not that they disagree with the need for the product, but rather that an increasingly large percentage have "no strong opinion" regarding the necessity for the product.

TABLE 12

"Most People Should Have Some Form of Insurance"
(Shown in Percentages)

	1980	1984	1989
Agree	80	78	72
No Opinion	11	16	22
Disagree	9	6	6

TABLE 13

". . . The Best Way of Protecting One's Family Financially . . ."
(Shown in Percentages)

	1968	1975	1982	1989
Agree	79	72	72	64
No Opinion	14	18	20	28
Disagree	7	10	8	8

TABLE 14

"Life Insurance Is as Much of a Necessity as Food, Clothing and Shelter"
(Shown in Percentages)

	1971	1977	1985	1987
Agree	67	64	56	50
No Opinion	17	19	25	32
Disagree	16	17	19	18

We also have a consuming public that, over the years, is less likely to view life insurance as a preferred vehicle for a whole host of financial security needs -- several of which might be termed "living benefits." (See Table 15.)

TABLE 15

Life Insurance Is the Preferred Vehicle for:
(Shown in Percentages)

	1968	1979	1983	1987
Children's Education	31	16	15	13
Retirement	22	16	14	12
Emergency Funds	13	14	12	10
Death Protection	87	81	76	69

It is indeed ironic that our industry once had a product that was marketed to answer a whole host of financial security needs -- both for living and death benefits. It was called permanent life insurance. But as a result of marketplace competition and companies' own marketing efforts, our industry has successfully "unbundled" this product such that it no longer is viewed as a oneproduct answer for a whole host of financial security needs. As they enter the 1990s, many companies will be attempting to "repackage" or "rebundle" this product as an answer to a host of consumer financial security needs. It will be interesting to see the success with which this strategy is met.

So, what does the 1990s have in store for us when it comes to product trends? First, and unlike many in our industry today who view the product revolution as being over in our business, I see ourselves on the verge of a very significant period of product proliferation. However, it will be a period of product development quite different from that which the industry experienced during the 1980s. For instead of brand new product concepts such as a universal life or variable life, it will rather be characterized by a number of other phenomena.

The first is what I call bells and whistles on existing products. Examples already in the marketplace include: accelerated payout riders on life policies (to date a small company product, but Prudential's recent announcement could serve to "legitimatize" the concept) and single premium deferred annuities (SPDAs) with penalty-free early withdrawal provisions for terminal illness.

Moreover, the ACLI has already proposed (to House Ways and Means in 1988) that: consumers should be allowed to use IRA, qualified pension/profit-sharing plan, and annuity/endowment/life contract proceeds to buy long-term care coverage tax free, and consumers should be able to exchange life and annuity contract values for long-term care coverage tax free.

And this is what I referred to earlier when I stated that companies will be attempting to "repackage" or "rebundle" traditional life insurance as providing funds for financial needs other than premature death protection. The risk in this, however, is that it exposes all or a portion of the inside buildup to taxation. For if you read both the General Accounting Office (GAO) and Treasury Department's recent reports on the taxation of our industry's products, it's clear that their major theme is equality of product taxation across financial institutions. Thus, to the extent we utilize tax-preferred life insurance monies for purposes other than death protection, we run the risk of running afoul of this theme. I also predict that before long this issue will form the basis for the next split between companies in our industry -- specifically, those favoring the use of life policies for "living benefits" versus those arguing to keep the product as pure death protection.

A second aspect of this product proliferation will be "product convergence" -- a term that I stole from my good friend, Hal Ingram back in Hartford. As the name implies, this refers to a blurring of the lines of distribution between products. I think we already have several examples in the marketplace -- again, the accelerated payout riders. I know of at least one state insurance department that didn't run on the product because it didn't know which section to send it to. Is this a life product? Is it a health product? Just what is this new animal? We also see in the marketplace another example, at least for the time being, in the corporate-owned life insurance (COLI) products. Again, this is life insurance being used to prefund postretirement health benefits. Certificates of deposit annuities provide another example. Again, these annuities are being marketed with all the characteristics of certificates of deposit, including multiple short-term guaranteed interest rates. And a new one that I just heard of about two weeks ago affects the long-term care area. I'm now told that we're into the third and fourth generation long-term care products, and one of the latest things to hit this marketplace is, in the interest of cost containment, borrowing concepts from the managed health care field, and we're now looking at a product which resembles kind of a long-term care PPO.

Finally, we'll be seeing a greater role of creative packaging and marketing of existing products. Examples already in the marketplace include: the selling of small universal life plans as a substitute for IRAs for higher income people no longer allowed to make tax-deductible IRA contributions; certificates of deposit annuity that I already mentioned; greater combinations of life and annuity products (e.g., for pension completion purposes); advertising that emphasizes living benefits (e.g., Northwestern Mutual's new "Life Insurance for the Living" campaign).

While most of the product development in the future will be of this nature, there will also be some *new* product concepts that we'll hear of before the end of the decade. For example, we've heard discussion of medical IRAs (and if for medical purposes, why not for children's education and/or purchase of a first home). And I think the President's family savings plan very much is along the same lines. Also, if there is accelerated payout for long-term care and terminal illness, then why not accelerated payout of product values for children's education and/or purchase of a first home? Third, retirement community products, again, are an area where our industry has taken a few stabs. Not much has happened, but I suspect somebody's going to be looking at it again. Demographics alone would dictate that.

Finally, there is home equity conversion and reverse annuity mortgages. Again, think about the changing demographics of our country and that most older people have their dollars sewn up right in their homes. This concept is very common in Europe and is really not unknown to our marketplace. There are two companies that I know of, Capital Holding in the U.S. and Seaboard Life in Canada, that have been piloting these products already. This past year there was also a Housing and Urban Development (HUD) program, an experimental pilot program which opened up 50 reverse annuity mortgages per state, 2500 across the country. That product didn't get very far because there wasn't enough business to allow the intermediaries to gear up to respond to that marketplace. However, you may very well hear more about that this year as that marketplace is now being opened up tenfold, and there will be 25,000 experimental reverse annuity mortgages across the country. And, if nothing else, one of the factors that's going to drive this whole area is the American Association of Retired Persons (AARP) and its lobbying efforts because it is very much behind home equity conversion and reverse annuity mortgages.

Of course, these products won't appear overnight. There are lots of regulatory hurdles to be surmounted before such concepts could become reality. However, I suggest that the pressure for answers to the future financial security needs of the public will increase to the point that some of these concepts will be seriously examined before the end of the 1990s.

Finally, I believe we'll see the reemergence of financial (security) planning. Just as some in our industry are saying that the product revolution is over, some in our industry today are also saying that "financial planning is dead." This view is summed up best in this cartoon. However, I offer that this is true only for financial planning as the industry defined it during the 1980s -- as a tax avoidance and/or a get-rich-quick exercise. If you agree with me that we're going to see the product proliferation that I discussed earlier, the result will be multiple ways of planning for and funding such needs as retirement, health care, and long-term care. Thus, the need will be greater than ever for quality financial *security* planning -- not just for tax avoidance/get-rich-quick purposes, or a specific product sale. Rather, the need will be for true financial *security* planning that responds to the evolving financial security needs of the public.

Interestingly, when asked in surveys the public has always expressed the desire for this. (See Table 16.) Things such as investments and tax avoidance are not high on the list when it comes to what the public wants from an agent under the rubric of "financial planning." And already we're starting to see banks and brokerage houses focusing on retirement planning as a key service.

TABLE 16

Interest in Types of Financial Planning Activities from an Agent (1988)
(Shown in Percentages)

Retirement	48
Property/Casualty	40
Children's Education	39
Long-Term Care	24
Estate Planning	23

Today we also see a public that is increasingly concerned with guarantees and the security of their dollars -- the return of their money rather than the return on their money. And with the recent S&L and junk bond debacles in our business, consumers will long remember the close of the 1980s as the years in which much more than just Perrier became contaminated. Fortunately, as much as our industry tried in the 1980s to give away our reputation of offering guarantees and financial security, we were unsuccessful. Consumers still look to us for security and guarantees. Thus, as we move into the upcoming decade our companies and the agent distribution system seem well positioned for the marketplace of the 1990s. Speaking of agents, let's turn our attention now to issues of distribution in the upcoming decade.

As with the area of product, we also have many in our industry today expressing the viewpoint that we're in for a relatively quiet decade with regard to distribution. This is perhaps best embodied in comments that are often heard today about "a reemergence of the career agency system" and that it's "back to basics." Well, here too I find myself in the role of resident contrarian, and will state that we could be in for significant changes in distribution in the 1990s, and that these changes will also be driven by the marketing principle.

Moreover, I believe that in many ways we're perfectly set up to repeat the events of the 1980s when it comes to distribution. Here I'm referring to the questioning of the agency system in the early 1980s, the experimentation with alternative distribution systems during the mid-1980s, and then the rejection of these systems and a recommitment to the agency system at the end of the decade. Although this time around there will be some fundamental differences.

Let me expand my thoughts further by reviewing four trends that will affect the area of distribution during the 1990s. As I just mentioned we're still in the middle of the period of recommitment to the agency system. This really began back in 1986 and 1987 when a few major companies embarked on significant recruiting and hiring goals, and the last two years have seen those companies continue on this track as well as other companies jumping on the bandwagon. Now right up front let me tell you that I'm a firm believer in the value of the agency system. Consumer research shows us over and over that's the key issue in putting the company close to the consumer. And consumers want to deal with a professional agent. Yet this trend causes me some great concern. The reason is that, while we're seeing companies significantly growing their field forces today, we're not at the same time witnessing any breakthroughs in the basic economic fundamentals of agency system management. I'm referring to factors such as productivity, retention, persistency and expense control. Sure, there are individual *companies* that have made progress in these areas, but the overall *industry's* level of performance in these areas has deteriorated or at best is the same as what it was a decade ago. And with our industry's lower product profit margins these days, there is a serious question as to whether this increased field force can be supported in the long run given these current industry levels of performance. Thus, in a few years I predict we'll have a whole new group of marketing executives who'll be once again lamenting over the cost of the agency system and wondering once again if we can distribute more effectively through banks, supermarkets, department stores, etc.

A major difference this time around, however, is that this questioning of the agency system will occur in a climate that is much more favorable toward deregulation of the financial services business. Within the last month, for example, Delaware's bill to allow banks to both sell and underwrite insurance represents a major step toward national insurance marketing efforts by the large money center banks and superregional banks. Another factor contributing to this pressure for deregulation will be the issue of reciprocity surrounding the formation of the European Economic Community (EEC). For in all the discussion regarding the EEC it's been clearly stated that large, European universal banks (banks that own life insurance companies and stock brokerage operations) should be allowed to offer nonbanking services in the U.S. as a quid pro quo for U.S. banks (such as a Citicorp) that provide insurance and nonbanking services throughout the world. Finally, if we look beyond our shores, we'll see that the U.S. and Canada are basically the only developed countries where financial services deregulation isn't a reality -- and Canada's regulatory barriers are on the verge of crumbling any day now. The point is that there is a clear model in the European and Australian universal bank concept for a deregulated financial services industry here in the U.S. and Canada.

Interestingly, deregulation in and of itself probably wouldn't have that big of a *direct* effect on insurance *distribution* as it will on the ownership relationships between banks and insurance companies. For many of these universal banks around the world today operate an agency system just as we know it today. The only difference is one of who owns the life company. In fact, one can argue that financial services synergy that everybody talked about in the 1980s can only occur in a deregulated environment, and that there is a very positive aspect to this universal bank concept. Specifically that it provides the agency force with a built-in flow of clients from the bank -- thus perhaps offering a partial solution to the Achilles heel of the agency system (i.e., prospecting).

The indirect yet more important impact of deregulation on distribution, however, will be that it will serve to legitimatize the utilization of alternative distribution systems -- leading to a resurgence of interest in this topic (especially that of banks) during the 1990s. The history of banks as a distribution system during the 1980s was really a fascinating one. And while it's fun to poke fun at the banks, we shouldn't underestimate their role in insurance during the 1990s. For clearly they will be back as a force in the marketplace -- and smarter for their experiences during the 1980s. Some of the things that will be different, for example, are that:

- While they're very interested in selling it they won't lead with life insurance. Rather, they will lead with more demand products such as annuities and long-term care. And if you really want something interesting to contemplate, think about a banking industry with expanded insurance powers and perhaps getting into the retirement and long-term care markets with monies freed up through a reverse annuity mortgage or home equity conversion product.

- There will be a role for third-party marketers. In the 1980s, in many of these joint ventures, we had the insurance company and the banks essentially enemies in some situations trying to put together a deal, and while, yes, they tried it, you really didn't get a sense that they were all that committed or at least that they were watching each other pretty carefully. Well, now we seem to have in the marketplace a whole host of third-party organizations that put the deal together and kind of perhaps comfort and minimize that natural situation between the banks and insurance companies.

- They will be moving downscale in their marketing efforts. For example, in *The Wall Street Journal* a couple of weeks ago there was an article about Chase Manhattan Bank. It said, "Chase Manhattan is embarking on a plan to open a nationwide system of investment service centers where well-off, but not truly wealthy, individuals can go for investment advice. The idea is to attract to the somewhat more spartan offices of Chase investment services individuals who would be persona non grata in the plush environments of the so-called private banking centers at Chase and other banking institutions." So, we have a banking industry that is going to be coming out in a much more downscale market and perhaps could have a more significant impact, and, again, depending upon regulation not only on the sales but also the underwriting of insurance.

A second phenomenon in the area of alternative distribution systems will be a renewed interest in direct response marketing methods. Look especially for the usage of telemarketing, and combinations of telemarketing and direct mail marketing.

Finally, there will be some competitors in distribution that perhaps we've never dreamed of, and one might be right under our noses. Several years ago, for example, the Marriott Corporation started a senior living services division. I commented on this two years ago. In a recent issue of *The National Underwriter* it was reported that it plans on having 150 retirement communities under development in the next five years -- making Marriott almost four times larger than any other provider. And, yes, it clearly intends to tie long-term care and other retirement products into this offering. The author used an automotive analogy saying that the actual bricks and mortar of the community will be the car, and the long-term care and other products would be the radio, an additional product that would be sold as a follow-up. I have also heard that Hyatt Corporation is looking at this same marketplace perhaps on a more upscale basis, and I also offer that some of the larger hospital corporations may also be a competitor in this area.

Finally, while I talked earlier about the effect of changing demographics on our marketplace and product offerings in the upcoming decade, we must also recognize that this external environmental factor will also impact the agency distribution system as we move into the middle and latter half of the decade. Specifically, with the baby-bust generation moving into the years of labor force entry, there will be fewer and fewer agency candidates in the age group from which we've typically looked to for new agents. As a matter of fact, if one projects out the number of people we contact today with career opportunities, by the end of the decade we'll be contacting almost every workforce entrant about becoming an agent. There are a couple of clear implications of this:

- In this light, we could say that the aggressive building of one's field force is a wise strategy indeed -- stockpiling agents if you will. Again, however, I don't believe that most companies can afford to do this given the issues of retention, productivity, persistency and expense control that we discussed earlier.

- As just discussed, this trend will also contribute to companies placing greater reliance on alternative distribution systems as a means of getting their products to the marketplace and generating premium income. It is another reason why alternative distribution systems might stick this time around.

- For those companies continuing with the agency system, the way we select agents will change with "selection" taking more of a "placement" complexion. And with agent selection as a major business of ours at LIMRA, I can tell you that this is one that we're starting to look at seriously.

- Also, we'll see the nature of our field forces change with increasing percentages of older agents, female agents, and agents from new immigrant groups, this as our immigration laws change to accommodate the need for a larger labor force in this country. This in turn will force examination of virtually every aspect of the way we develop, manage and compensate our field forces. For example, will these new agent groups be as responsive as today's agents are to our traditional incentive compensation approaches? Perhaps it is another factor driving us toward levelized compensations. Also, it raises many basic logistical questions. In this new environment, what for example, is the nature of the spouse's program at the 1998 company sales convention?

All in all, these are some fascinating issues and questions to ponder.

So there you have it, some thoughts on how we'll be responding to the marketplace of the 1990s in terms of both product and distribution. No doubt, I'm sure that many of you find some of my thoughts a bit far out, and in all honesty, yes, I've exaggerated a tad in some areas to get your attention. The important thing for all of us to remember, however, is that all the changes in product and distribution that I've discussed are driven by the marketing principle and external environmental factors such as demographics and government regulations -- factors that we know (1) will change and also (2) how they'll change. So, as for my predictions regarding product and distribution, it is perhaps not an issue of whether there will be change, but rather one of how far-reaching this change will be. And while most crystal-ball gazers make it a point never to return to look at the accuracy of their predictions on the future, I can't wait until 10 years from now to see the nature of our business and how far on/off target I am. Perhaps I can visit with you again in the year 2000. Until then, best of luck.

MR. AFFLECK: In regard to your comments, it seemed to me that the constant theme was one of change, and I think that's encouraging to us as actuaries. Many of us have felt change was slowing down, and I think what you're saying is not to bet on it.

MR. JAMES R. THOMPSON: I was impressed with the annuity growth statistics, and it occurred to me that that might be due to sales through the stock brokerage rather than conventional agent distribution systems. I was wondering whether you had any breakdown on that.

DR. ZULTOWSKI: I don't have an exact breakdown, but I think you're right. It's a factor in there. My suspicion is that it was more of a factor in the mid-1980s and that the agency system was really a bit behind on that trend, but in the later part of the 1980s we certainly see many companies, agency forces, out there very actively marketing annuities, and I would say, it's more of a factor of the agency system's activities, and certainly that's where the numbers are to produce that business.

MR. SHAWN R. COWLS: In your marketing changes and trends for the 1990s I was a little surprised that you didn't mention level commissions at all. Do you think there's going to be a movement towards that or has the insurance industry dumped it?

DR. ZULTOWSKI: I think the insurance industry right now can be characterized as watching it very carefully. I'm sure most of you are aware that one situation that most people have their eyes on is in Canada with Mutual Life of Canada, basically being at a levelized type system for about a year now. One of the things that I think is very significant is when people talk about the Mutual experiment with level commissions, it's a lot more than just level commissions. If you get into that system and understand what's behind it, there are several very interesting things that they're doing relative to bonuses and buying back pieces of business from agents if their clients move across the country and that sort of thing. So, my feeling is that just level commissions in and of itself is not going to be a reality unless it's also combined with many other kinds of programs as Mutual is doing. One of the reasons why I think it hasn't gone faster is that it's not something you do overnight because of system requirements. Mutual will buy back pieces of business from individual agents and sell those pieces of business to another agency in another part of the country. Their systems were able to track individual pieces of business very carefully and not just blocks of business. So, they, for years, were building their systems, getting ready for it. A second point is that you may know that they're paying increased renewal commissions on all business. So, essentially they're, to a large extent, paying for a single piece of business a second time, and this was something that they figured was the only way for the agency force to get from the current situation to level commissions, and, consequently, they were essentially saving for that for a long number of years. There's a minor wrinkle in the ointment, and that's the agency system; basically this is not an issue that's dear to many of the field people, and it's not something you do overnight. So, I think (1) there are going to be many companies that are going to be simply not in the position to do it in the future, and (2) for those who might be moving toward it, it's going to take some time. But I don't believe at all that it's been dumped as a concept. I think people are just watching it very closely and trying to figure out if they should do it, and, if so, how they can.

FROM THE FLOOR: In the product mix numbers that we saw, interest-sensitive whole life products were lumped together with the regular whole life products. Why is this done, and is there any further breakdown on that?

DR. ZULTOWSKI: That's an excellent point. We started back in the early 1980s when the current assumption whole life products came on the street. We started to break it out as a separate product, largely reflecting some of the new interest-sensitive products that were out on the street, especially those that stock companies were offering. As we got further into it in the mid- and late 1980s, it essentially got to the point where it was almost impossible to really distinguish those products. For example, one problem -- as some companies were reporting data to LIMRA, they were calling current assumption products, those products that had just current mortality assumptions but not current interest rate assumptions. So, we had confusion on that point. Also many of the mutual companies were saying they were offering an interest-sensitive or current assumption product, but it's not the same kind of product that the stock companies would consider was a current assumption product. So, essentially, to be honest with you, we kind of threw up our hands and said that it's very difficult to get a clear definition of what this interest-sensitive product is anymore and lumped them back together. I would venture to add, that -- and, again, I don't have a specific breakdown on this -- if you look at that whole life category, the vast majority of it is some kind of interest-sensitive product. The industry has basically moved that product to that category. But we, in all honesty, threw up our hands trying to define it.