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INTERNATIONAL BUSINESS TECHNIQUES

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o This session, targeted at the experienced business person, takes a look at techniques used in the insurance business from around the world. What can be learned from the way business is conducted in Europe, the Far East and elsewhere that can be applied to the insurance industry in North America?

MR. WILLIAM J. BUGG. JR.: I am senior vice president and corporate actuary with AFLAC, the insurance subsidiary for American Family Corporation. This session is an open forum, and as such, a broad discussion of the topic is appropriate, and we expect substantial participation from the audience. We will start off with presentations from our panelists, and then the floor will be open for discussion. This session comes under the management specialty track. As such, we will be discussing some of the ways that insurance business is carried on in various countries in the world. There are many different problems and issues which one faces when managing a company in a foreign country. The topic is a very broad one, but we have chosen to focus on such things as the regulatory environment, distribution methods, the competitive environment and general business conditions. These are just a few of the many things that one faces when operating in a foreign country. It's always interesting to find out how other countries operate and how other people do things. Perhaps through our discussion today someone might discover an idea or a management approach which could be applied here in the U.S.

We have three panelists with us. Linda Emory is senior vice president with Life of Georgia and its parent company, Georgia U.S. Corporation. Georgia U.S. Corporation is owned by the Nationale-Nederlanden, a Dutch company. Ms. Emory recently completed a unique and interesting two-year assignment in The Netherlands where she served as manager and international actuary for Nat-Ned. Her duties included a review of corporate strategies, life product profitability, potential acquisitions and earnings analysis. She was also involved in special projects to assist and support the Nat-Ned executive board with its management of operations in the U.S., Canada, Great Britain, Australia and the Far East.

Ms. Emory is also the editor of *The Actuary*, the Society's newsletter. Under her guidance the newsletter has expanded to its present form. She's been very active in actuarial and industry organizations. She has served as president of the Southeastern Actuaries Club and Atlanta Actuaries Club, and she is past vice president and board

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member of the Society of Actuaries. She's a graduate of the Georgia State University where she received a BS degree in mathematics. She has served on the board of trustees for that university and also as President of Georgia State's Alumni Association. She's married to Joe B. Emory, president of Emory International, who spoke at the session European Harmonization.

Alan Lockie works for Victory Reinsurance in London where he is manager of actuarial development in the overseas life marketing department. Prior to joining Victory, Mr. Lockie was employed by the National Provident Institution where he worked in a number of different areas: valuation, product development and group pensions. At the time he left, he was corporate finance manager. Mr. Lockie joined Victory in 1987. His main responsibilities at Victory are reinsurance marketing through a number of European countries, consulting on the actuarial aspects of health reinsurance on a worldwide basis, and special projects of an actuarial nature. In addition, Mr. Lockie is a director of Elmac, a subsidiary of Victory. Elmac undertakes a wide range of consulting assignments on a European-wide basis. Mr. Lockie obtained a bachelor of science degree in mathematics and statistics from Bristol University.

Joseph Dunn is a former senior vice president at Prudential Insurance Company. As senior vice president at Prudential, he directed the sales and marketing operation for 20,000 Prudential agents in more than 1,000 offices throughout the United States and Canada. In an earlier assignment he was responsible for establishing Prudential Life Insurance marketing operations in Japan in a joint venture with Sony and, subsequently, the creation of Prudential's wholly-owned life insurance subsidiary in that country. He has served as chairman of the board of the Prudential Life Insurance Company, Limited in Japan, Prudential of America General Insurance Company in Canada, and Prudential Property and Casualty Insurance Company. He continues to work with Prudential as a consultant, working with their operations in Japan, Korea and Taiwan. Mr. Dunn is a graduate of Syracuse and NYU Universities and holds a chartered life underwriter designation.

Kermitt Cox is vice president and international actuary with AFLAC.

Ms. Emory will be the first of our panelists and will discuss nontariff countries in Europe. Mr. Lockie will follow and will discuss management in a tariff environment as it exists in many countries in Europe. And Mr. Dunn will discuss practices in the Far East.

MS. LINDA B. EMORY: I would like to share some of the experiences I've had over the last two years. I'm going to begin with a brief overview to set the stage for my colleagues on the panel. Then I'm going to talk a little bit about the two countries where I had the most experience in Europe. My general thesis, as far as management techniques are concerned, is that we're all in this together. The program says, "What can we in North America learn from the other countries?" but I think these days we're going to have to all learn from each other. It's getting to be a smaller and smaller insurance world.

Table 1 shows the three major insurance markets and includes all kinds of insurance -- life as well as property and casualty. These were 1988 figures. I noticed that the figures you're seeing at this meeting vary, so don't pay so much attention to the exact figures as to their general message. This particular chart came out of *The Economist* magazine. The United States, with 240 million of population has $430 billion of $1.1 trillion premiums, or 38% of the world's insurance market. Japan, with a population about half as large has about half as much in premiums. And if you put the 12 European Community countries together -- this was before the recent changes in Germany, of course -- there is about 325 million of population and about the same premium volume as Japan according to this tabulation. What I think is interesting is to look at the growth in the market measured as a percent of the gross national product. Comparing the growth in insurance as a percent of GNP between 1970 and 1988, the United States has had a growth of only 7-9%. Japan has grown from 4-9%. And Europe, from 4-6%. So, there's been faster growth in both Japan and Europe than in the United States. I suspect if we'd looked earlier, before 1970, we would have seen the United States looking a lot better. I think we can see now why companies from the United States are looking to these other markets -- because they're developing fairly nicely, and because they have potential for greater increases in their markets.

TABLE 1

All Insurance Premiums in 1988

	Population	Premiums	Percent of GNP 1988	Percent of GNP 1970
United States	240 Mil.	$ 430 Bil.	9%	7%
Japan	122	260	9	4
Europe (12 EEC Countries)	325	270	6	4
Total		$1,132 Bil.		

Table 2 shows just the life insurance premiums. This was based on 1986 statistics, but I think recent results show Japan is coming on even stronger. The United States and Japan are much closer on the basis of life insurance only.

TABLE 2

Life Insurance Premiums in 1986

	Premiums	Premiums per Capita
United States	$ 150 Bil.	$621
Japan	119	981
Europe (12 EEC Countries)	80	248
Total	$ 494 Bil. (51% of Total)	

Europe has about half as much premium as the United States. Per capita, Japan is much higher than the United States, and Europe lags behind. Bill told me he has seen some recent statistics which place Japan's premium income higher than the United States for life insurance. I wouldn't be surprised.

And now if we zero in on the countries in the European Economic Community, Table 3 shows how the premiums vary by country and also takes into account their populations. Note that Italy, Spain, Greece and Portugal have very low premium per capita, but their economic situation is improving. This may partially explain why some of the American companies are moving into these markets; they see a lot of promise for growth which will be supported by the single European market.

TABLE 3

EEC Life Markets in 1986

	Population (in Millions)	Premiums (in Billions)	Premiums Per Capita
West Germany (1)	61.1	$25.3	$414
France (2)	55.4	14.2	256
Italy (1)	57.2	2.6	47
United Kingdom (3)	56.7	27.2	479
Spain (2)	38.5	1.1	28
The Netherlands (3)	14.6	5.2	359
Belgium (1)	9.9	1.4	142
Denmark (1)	5.1	1.6	308
Greece (1)	10.0	0.1	14
Portugal (2)	10.2	0.1	7
Ireland (3)	3.6	1.3	361
Luxemburg (1)	0.4	0.0	125
Total	322.6	$80.2	$248

Please notice the numbers in parentheses located next to the country name. These numbers refer to whether the countries are tariff or nontariff markets. I'm going to define what we mean by tariff and nontariff. The countries with (1) by them are what we call the tariff countries. They're very heavily regulated, and Alan's going to talk about them. The countries with (3) by them (the U.K., The Netherlands and Ireland) are what we refer to as the nontariff countries. Nontariff generally means a great degree of freedom in product pricing and, within limits, in setting reserve requirements. One definition recently given for a nontariff country is, "the actuary has considerable responsibility for insuring solvency of the company," and a system of supervision demands a strong, local actuarial body with close contact of actuaries in the market with the supervisory body. In this particular environment, a greater variety of products and product innovation exist. And I'm going to talk a little bit more about the U.K. and The Netherlands. The countries identified with the (2) (Spain and Portugal) are somewhere in between tariff and nontariff. There's sort of a balance between tight regulatory control and innovation in new products being allowed.

Although considered a nontariff country, in The Netherlands, a few companies control a very large part of the market, and those companies have chosen to regulate themselves and to operate more like tariff countries. In most cases identical premiums are charged for identical products. The products are participating, and there is a formula which returns specified amounts of profit to the policyholder. Other nontariff countries are the United States, Canada and Australia, of course.

The U.K. and The Netherlands have in common their relatively sophisticated markets, and their relatively high premiums per capita compared to the other European countries. In each one of these countries, a small number of companies control a large percent of the market. In The Netherlands, three companies control over 50% of the market. That's a large amount of control. And in the U.K., it's true to a certain extent. About 10 companies control 58% of the business. I think the largest company, the Prudential, has about 14% of the market. So, that's quite different from the United States, but then they are much smaller markets.

The principal products in both of these countries are very similar, primarily mortgage endowment and pension business. In the U.K., in the past, there were heavy tax incentives for saving through mortgage endowments. Even though the U.K. now taxes the inside buildup, almost all of the annual premium life business is still sold in connection with a mortgage. There's still tax incentives for pension plans in the U.K.. So, a lot of pension business is also sold.

In The Netherlands there are currently very heavy tax incentives for the sale of a mortgage endowment. When you take out your mortgage you pay interest only, and you accumulate the funds to pay off the mortgage through this endowment contract. Also there's a very nice amount, about $8,000, that can be contributed to a single premium pension and deducted from taxable income. At the high Dutch tax rates -- formerly 72%, but 60% this year -- that's a big incentive for a lot of pension business and mortgage endowments. One really interesting thing is that the U.K. contract doesn't have the guarantees that we have in the U.S. market. When you don't have the guaranteed cash values, assets can be invested, to a great extent, in common stock as they are in the U.K. even when this is not unit-linked business, but what we would call participating policies. About half the assets are in common stock and maybe another 15% or so in real estate in the U.K., and there has been a history of a very nice return from these investments.

Other things that I observed in these two markets is that there seem to be lower lapse rates in both of these markets than you see in the United States, perhaps higher expenses, but also higher profit margins. I had expected that the U.K. market would be very competitive and would have much lower profit margins because we know that they compete for the savings dollars in the U.K. My actuarial friends tell me that the profit margin for the savings mortgage endowment is about double what we would expect from a similar policy in the United States. In other words, they express profit margin on a present value basis as a percent of first-year commissions. This turns out to be 40% of an annual premium, whereas, the comparable U.S. profit margin is more like 20% after tax. The U.K. expects fairly high increases in sales in the future because of the link to mortgages and the expectation of an active housing market. The U.K. places a lot more value on their projections of future business in an actuarial appraisal value than we would in the United States.

Now let's talk a little bit about the distribution system in these two countries. In both countries there is a fairly large amount of business sold by independent agents, and this method of distribution is causing some of the big changes in these countries. The Financial Services Act in the U.K., for example, has almost destroyed the independent agency system. Whereas the U.K. doesn't heavily regulate the prices of the products or the valuation, it does regulate the distribution channel. The Financial Services Act basically says the agent must either be "tied" to a company; that is, sell business for only one company, or give independent advice. Independent advice charges the agent with looking at the whole market and doing the best job for the consumer.

Because of this burden which has been placed on the independent agent, there has been a wholesale movement to becoming tied agents. If you had a company that had an independent agency force, your whole distribution channel has now fallen apart on you. Of course, you're going to try your best to tie agents. This is being accomplished by insurance companies buying either estate agencies (real estate agencies), or building societies (savings and loans), or building their own direct marketing force. This is just the opposite of what's happening in the United States as we move from tied agents to independent agents to reduce the costs of our distribution system.

In The Netherlands this strong, independent agency force has encouraged companies from other countries (usually U.K. companies) to establish operations and start selling new products.

Unit-linked products (variable universal life) and universal life products have recently been introduced. Although there's been about an 8% growth in the Dutch market over the past few years, most of that increase is going to these new companies. Competition is intensifying to the extent that the big companies now are beginning to offer these new products also. So, the life insurance environment is really changing in both of these countries.

The other thing that's really changing in both of these countries is that the wall between the banks and the insurance companies has come down. The expectation is that there will be even greater use of banks as distribution channels in the future.

The result, it seems to me, is that we're more alike than ever before, the United States and Canada versus The Netherlands and the United Kingdom. We're selling similar products. We're selling universal life and unit-linked (variable universal life). When something happens on one stock exchange, it happens all over the world. Then we all stop selling these kinds of products, or we don't sell nearly as much as we need to sell to cover our overhead. The tax laws are becoming more similar. The deferred acquisition cost issue has just come up in the United States, and it sounds a lot like the way costs are amortized in the U.K. U.S. companies are looking at the prospect of flat sales and slower economic growth. So, we're beginning to look to other countries for growth. The Europeans have been doing that for a long time. My company came to the United States about a hundred years ago. They didn't stay. They pulled out, but they came back 20 or 30 years ago. They currently sell in 22 countries. Nat-Ned expanded internationally for the same reason that American companies are looking abroad now: for additional markets, ways to diversify risk, and ways to improve profits.

So, back to the theme that we're getting more alike. We all have more competition. We have more expense pressures. Our distribution systems have some of the same problems. I'm sure the computer system problems are very similar. This is why LOMA and LIMRA are going international. This is why we're at this meeting. We want to learn from each other and share with each other. Insurance is a lot alike. It varies, of course, by the countries and their regulatory environment, their tax environment and their cultures. One business practice we can learn from the Europeans is their long-term view. They've had patience. Europeans know that there's a diversity of cultures, and they've been very good at looking into these different countries and operating within the rules of those countries. I think Americans must use some of the same techniques if they are to prosper in their international expansions.

MR. ALAN WATSON LOCKIE: My definition of a tariff probably coincides with Linda's countries identified as (1) on Table 3. Basically, you charge what you are told to charge for the products that you are allowed to sell. The classic example of this is West Germany where all products must have exactly the same premium rate and exactly the same policy conditions. German supervision dates back about 82 years (I think the act was 1908), and the basic principle was that the consumer knows nothing and needs complete and total protection from the insurance companies. German supervision comes from that very principle and still exists today.

In such a situation do you actually bother, then, to compete with the other companies if you're charging the same rate for the same product? We've heard that in Holland there's a certain amount of cooperation, and the same is true in Germany. The companies have an almost formal committee where they sit down and discuss whether they want to do anything different and, if so, they'll all wait for everybody to catch up and launch it at the same time.

Similar things happen in other countries but not necessarily to the same extent. Stepping slightly outside the European Community for a moment; in Sweden they're just about to launch variable products. I've been speaking to one or two Swedish companies about this, and they're very uncomfortable about some of these aspects because, before now, in their conventional business style, they've always talked to each other. They charge the same rates for essentially the same products. Now they're working in the vacuum in which you and I are accustomed, trying to second-guess what the others are up to, and it's unusual for them.

If you do want to compete where you're charging the same premium and the products are the same, it can be a bit difficult. There aren't many areas to compete in. The key thing -- this happens in Germany and will happen in the other countries -- is the dividend or bonus scale you give back. You look to give as much back to the policyholder as possible and make this the main feature of your sales presentation. If Company X says it returns much more than Company Y, then they will use that as their competitive advantage.

Another way to compete is by the availability of certain types of riders: accidental death riders, waiver of premium or hospitalization riders. In Greece, for example, which is a heavily regulated market, the life policy is an incidental part of an entire package. Over 50% the premium in all policies is for hospitalization, accident and other riders. The average sum insured or face amount for a Greek's life insurance policy is only about $2,000, and that accounts for only about 40% of the total premium for the actual policy.

Other areas you may try to compete in would be service or sales outlets, advertising -- that kind of thing. Given this situation, what do you think your corporate goal should be? I think certainly the British and the Americans would say, "Well, we should maximize profits and the return on the equity or the capital in the company." That's pretty difficult under a tariff basis, since you're told what to charge for what risks.

Also, in some countries, Germany, Denmark, and Sweden, the life operations have to act as quasi-mutuals; i.e., all the benefit must pass back to the policyholders with virtually nothing left for the stockholders if there are any. There are tricks to get around this like the fact that some life companies only employ two people and then have all their administration done by what is technically called a third party at somewhat inflated rates. There are other tricks as well, but I won't give them all away at the moment.

So, how do you maximize profits if you've got a tariff basis? Well, let us look at the classic actuarial elements of a premium. You can look at mortality and say, "I'm going to be very strict on my underwriting, only take the good, quality lives, make sure I don't have more than expected death claims and so forth." You can try that, but it is very difficult in some of the markets where underwriting is lax by U.S. or U.K. standards and not really worthwhile. Certainly the profits probably aren't worthwhile given that most of the products are savings products with a very low death strain at risk. So, you're not going to have much in the way of mortality savings.

You could look for a good investment margin between what you earn and what you give back to the policyholders. This is difficult as well. If I had the key to successful investment, I certainly wouldn't be standing here. It's also difficult due to competition. You could argue, "If I give more back to my policyholders, I'll write more volume; if I write more volume, I should be making more profit." It's very difficult to know which is the best way forward, and I don't think anybody's found a successful answer.

Given that your tariff basis should allow you to be profitable, should you then maximize sales? Well, that's easily said for us here, but not always easy to do in practice. There are costs to distributing your products, setting up more agencies and so forth. Furthermore, your valuation basis will generally be constrained. (You may or may not be allowed a Zillmer reserve, and, if so, the Zillmer effect will not seem particularly large.) If you try to expand too quickly, you could have surplus strain problems, and then you'll have your supervisors down on your back fairly quickly.

Probably one of the best areas where you can improve your profit margins is to minimize your expenses. After all, you have fixed allowances in your product rates. If you can then minimize the expenses, then you should be making more money. Again, one of the things you might want to do is write more volume to get more margins, but this may reintroduce the surplus strain issue once more. I think one of the advantages here to newcomers, if you're going to be a newcomer to the market, is your administration systems are probably going to be more efficient, more lean, than those of the existing players. I was talking to a very large Italian company about two years ago concerning universal life products; the principles of them, how they work, etc. These things still don't exist in the Italian market, but they might turn up one day. And I was trying to explain that if you're going to deduct cost of insurance on a regular basis, or a monthly basis, you're going to need a new and good computer system to do it. The gentleman I was speaking to said, "No, no problem . . . Don't need one . . . Not interested." And when I actually managed to pin him down as to why, he said he had 200 people sitting downstairs he couldn't fire due to social security laws, and it's about time they did some work! He has a problem in that he's carrying huge overheads. But a new company coming in could have two people instead of having 200 people sitting downstairs, and hopefully make a little bit more money.

But should you actually be maximizing your profits? I think that's a natural assumption for us here, but in many of the other European cultures it's not. The goal might not necessarily be maximum profits, it might just be sufficient profits. If you're a stock company, you're not going to have many investment analysts breathing down your neck wanting to know what the quarterly earnings are, why they have gone up by only 5% instead of 10% compared to Company Y down the road, etc. Shareholdings are much more tightly held, often by banks who take shareholdings in return for having made loans earlier in a company's organization. They're only looking for sufficient profits to meet cost of capital and not necessarily to maximize those profits. So, the pressure on management isn't necessarily as great. Also without that pressure, the time scale requirements are a lot different. These companies may be prepared to wait a long time for their money to come back rather than two or three years or even shorter in some cases. Given that new business production for these products will involve a large surplus strain, it's probably just as well.

You may have other goals. Your main company goal may be to increase your business; to have a large market share. Again, I think I've identified the problems of doing that, but in a number of countries this is very much the main aim of management. Much of their corporate goal is probably intangible, and they look for things like prestige, standing in the market, etc.

So, what's the role of the actuary in the tariff market? Well, unless you're actually working for a supervisor where you probably have some clout, it's very limited. In France, which is a relatively liberal market, it has often been said that the best actuaries actually work for the supervisory body, though I think that situation is changing within companies. The company actuary is really only concerned in carrying out a liability valuation, signing off to say that the reserves determined for your balance sheet at the end of the year are in accordance with the bases laid down by the supervisors; that's pretty much the limit of your role. You pop out of your box every March or June, depending on the time scale, sign that particular part of the account, and get locked away again. The actuaries don't get involved very much in the asset side, or in product development. Pension involvement is fairly limited in a number of these countries, although that's changing now. Moreover, actuaries have a limited role in overall management of the company. The management tends to come from other areas, not just the actuarial area which has, I think, been the case in the U.K. and the U.S. to some extent. Often these actuaries are extremely good mathematicians; they have very good math degrees, but they're not necessarily solving the problems that other actuaries in the U.S. and the U.K. are doing.

What are the lessons for the United States? Well, I'm not really too sure. Cooperation is nice. I think it's legally limited here, but it's nice. It's comfortable, and you don't have too much pressure on you. I'd emphasize what Ms. Emory said. If you can learn patience, and that's not easy, then that can be a major help. Also recognize the cultural differences. Due to their geographic size and proximity, Europeans learn to have open minds about different cultures to a much larger extent, and I think if you do want to go and work in Europe, you're going to have to recognize the different cultures, not only between countries but also within them. Technically there may not be a lot to learn, but there are different styles of working, and different styles of working tend to fit these countries. It would be very difficult to impose other styles on them very quickly.

MR. JOSEPH DUNN: To give my comments some context, I would like to explain very briefly what Prudential's exposure has been internationally. In the life insurance business, we have been in Japan for a little longer than 10 years. We are currently moving into Taiwan, Korea, Spain and Italy, but all of those last four operations are very embryonic, just getting off the ground. So, most of our experience has been in Japan.

This session was advertised as identifying techniques used in foreign countries that could be applied in the United States. I had some difficulty in identifying those techniques used in Asia that could be applied here. The Far Eastern industries generally have been taking their lead from the U.S. in terms of both product and management processes. The environment in these countries has really not encouraged innovation. In terms of specific techniques, a few come to mind that I believe would be helpful to us. One is the use of automatic bank transfer. We have the structure here in the United States where we could possibly use that a great deal more than we do. I think this is important. Somewhere over 90% of our premium collections in Japan are through automatic bank transfer or payroll deduction. Our first-year persistency rate is 96% and is much better than the industry average. The premium collection techniques are not the total reason, but we are convinced that they do make a major contribution.

Mr. Lockie was discussing expenses. In Japan, generally, we use company physicals that have been administered in the last six months for underwriting purposes. We adopted that practice, and we find that it's perfectly satisfactory, thus, expenses are significantly reduced. In terms of management itself, the Japanese companies take a much more ceremonial approach to induction of people into the company and provide visible identification with the company. This has proven to be very important in developing company loyalty. In the Far Eastern countries, they pay a lot more attention to competition. This might sound a little strange when I say there hasn't been much innovation. And certainly when we're talking about tariff and nontariff countries, believe me, these are tariff countries. Everything is regulated. But their attention to competition is to make certain that nobody gets ahead of them or gets the lead on their company. They do pay a lot more attention to it, and know a lot more about their competition than we do here.

Now, there are a lot of positives in moving into the countries that Prudential has chosen, countries with growing economies. There is a public awareness of the need for life insurance, and it has not been completely served by the domestic insurers. There has been tremendous industry growth in these countries, and we are certain that growth is going to continue. There are also some negatives. You do have regulatory control, and this is not the easiest thing in the world to deal with. You are not welcome in some of these countries, partly to protect the domestic industry, which is understandable, but, again, it makes things a little more difficult. Also, you are operating in very different cultures, and you have to learn how to deal with those cultures and work differently than we do in the domestic marketplace. These are negatives, but they do lead to some lessons. There is much to be learned from moving into a new marketplace where you're not restricted by precedent. You have no experience, and you must cut a new pattern. So, there are lessons to be learned.

Now, what I'm going to say will sound like platitudes, and maybe they are, but they are principles that we often voice here. We talk about them, but we don't practice them. The first major factor to consider in moving into a new market, either here or abroad, is to understand that market and to understand the consumer. It's critical. We, here, as those in all of the foreign countries that we have operated in, tend to rely on conventional wisdom. We feel we don't have to learn things about the market because, after all, we're part of it, and we know. It is very important not to rely on conventional wisdom. Conventional wisdom in Japan is no better than it is in the United States, I guarantee you. It's important to have a clearly defined market objective and a detailed plan to reach that objective. Unless you know in specific terms where you're headed, and unless you have a plan that you're going to stick to, you're not going to get there. Another thing that we've learned is that extensive experience is not necessary for individuals to function well.

Well-designed and administered training with proper reinforcement will bring people to the desired level very quickly. That's true in both the field and the home office. Experience is necessary in only a few technical areas. In the U.S. nobody can become a field manager without X years of experience. You can't move up in the home office unless you have experience. In Japan, particularly with field management, we set forth the principle that we would hire no experienced life insurance people in the company except in actuarial, accounting and underwriting. We let down the bars a few times in field management and hired people from the Japanese industry. The only management failures we had in the operation were people that we hired from the industry. We didn't have one success. Those without experience who we took in and trained for six months proved to be very successful. They hit the street running, and things worked out very well. We also learned that you can attract quality personnel even in a negative atmosphere if you're willing to sacrifice short-term gain and put forth the effort to maintain your standards. This is not easy. In fact, it is very difficult, but that's where that clearly defined objective and a detailed plan come into play.

Expectation level is the key to performance, and that is why people who we brought from the industry into our operation were not successful. Their expectation level was completely different. They couldn't relate to our objectives. A full-time agent in Japan is defined as somebody who writes two cases a month and reports to the office twice a day for five days a week. They just could not relate to the levels of productivity that we needed.

Some elements are critical when moving into new markets, either here or abroad. You've got to differentiate yourself. We started our operation in Japan with a total of something like 30 agents competing against Nippon Life with 60,000 and, Dai-ichi Mutual Life with 50,000, etc. There is no way that you can compete directly in those markets with those companies by doing business the same way. You've got to differentiate yourself. The best way to differentiate yourself is in terms of quality. In the Far Eastern countries in which we're involved, the industry is not held in high regard. The basic problem is that the quality of the domestic industry is not considered good. If you can develop quality in your distribution system and in your service, it will go a long way toward success. You have to differentiate. It is possible on rare occasions to differentiate yourself by product. You, perhaps, can get some short-term competitive advantage, but it won't last. Product is very important nonetheless. We just stole the march in Japan. I don't know how it happened. We introduced the second-to-die policy. Japanese companies weren't interested for some reason. They were a lot more interested in living benefits. The policy is doing very well. So, it's possible -- short-term advantage but not long-term gain.

Regulation in tariff countries, with tight control of the rates, product, and even investments, to some extent, leaves, as Alan said, expense control as the only real avenue you have to maximize profit, or at least to get sufficient profit. Here the actuary can play a very important role. As Mr. Lockie said, administrative systems are certainly one way to minimize expenses, and you do have an advantage because you don't have a large superstructure to deal with. There are also indirect ways to control expenses. One important way to make a contribution to expense margins is through your field compensation plans. If your field compensation plans are designed in such a way as to minimize your lapses and to maximize your sales, you can contribute to expense control. When I talk about maximizing sales, we tend to compensate based upon results. You can go a long way by rewarding activity, not just results but activity, and this is important in the development of compensation plans. Another way that you can indirectly control expenses is by the quality of your hire. The quality of your hire and the minimization of turnover makes a major contribution to your expense level, and you can take different approaches to this. I will mention one company. They started off, I think, with something like 400 agents. They're now down to 200. We started with 40 and are over 200 and climbing. There is a big difference in the expense implications of those two operations.

Another element that is very critical is understanding how to deal with regulators. They're not easy to deal with. One of the positive things you have in Japan is the high intellect of the government people. Most of the Ministry people that you're dealing with are Tokyo University graduates. They are very capable and very competent. It's very important to learn how to deal with them because of the tight regulation. The relationship that you develop with the Ministry affects how much leeway you have to operate and how much they'll require of you or not require of you later. Overall, I think the key -- Mr. Lockie mentioned it -- is to have patience, be flexible, and maintain a high tolerance for ambiguity. Patience and flexibility, I think, are the key elements in dealing in these markets. A high tolerance for ambiguity is also a decided asset. Remember that you have one tremendous advantage in moving into those new markets. The established companies are locked into a number of practices. They are locked into their history. They are locked into their current staffing. And it's going to take them time to change. Even when they desire or want to change, it takes time. You have a blank sheet when you're moving in, and if you do it right, you'll get a head start on the existing companies.

MR. BUGG: Our presentations are complete. The floor is now open to comments and questions.

MR. ROY GOLDMAN: I have two questions for Mr. Lockie. First question. You had mentioned that in the U.K. and in The Netherlands most of the life insurance is mortgage-related. Do they have the same kind of turnover in mortgages that we have in the U.S., and, if so, what would be the implication for sales? Second question. In the West German situation where you have tight regulation, you mentioned the role of the actuary is primarily related to the establishment of liabilities. Who develops new products? Couldn't a company come up with a new product that another one doesn't have?

MR. LOCKIE: Regarding mortgages, I don't honestly know what the U.S. experience is, and I don't know what the Dutch experience is. In Britain, the quoted figure is that the average length of mortgage is something like seven years. One of the bonuses you have with an endowment mortgage is that you can keep the same endowment for the new mortgage. So, for example, I'm on my third mortgage now because I probably don't move as often as other people, but I can still use the endowments I took out many years ago to support that. So, I don't suddenly have to take out a new endowment for the full amount every time I move to a new house. There is a certain amount of bad practice in the United Kingdom where the poor salesman says, "Oh, no, you've got to surrender your existing endowments, take out brand new ones with me." That's one of the reasons why we have this dinosaur called the Financial Services Act -- to, in theory, stop that kind of thing.

I don't know much about Dutch mortgages. I am aware that there's been a big shake-up in the Dutch mortgage market recently. There has been a large movement from a typical repayment basis, as you know it, to the endowment basis that I know, since they've discovered this neat new product called a savings mortgage. Basically what happens is you just pay interest on the loan till the end of the term. You purchase a special endowment policy where, after the insurance company has taken off a small margin for expenses and profit, the rest of the money goes straight back to the lender, so that the lender's cash flow is exactly the same. The insurance company should make a small profit, and the borrower is much better off because he or she is getting much more tax relief because they're paying the full amount of interest throughout the term of the loan, and the endowment has a gross roll-up.

If I switch to your second question about product innovation in a tariff environment like Germany, I could perhaps ask you, What product innovation? They would claim to have had about three new products in the past dozen years in the German market; one of which is just an extension of a long-term disability product. Another one is a type of long-term care product which is quite interesting. They pay their benefits purely based on the activities of daily living, and if you are unable to do two out of the six activities that they specify, you'll get a 30% benefit; four out of six may give you 75%; five out of six will give you 100%. There are all sorts of other twists and tails on this particular product. Sales have not been particularly good in Germany for this product.

Their third area of development is variable life, which has been confined to just a few companies. In developing these products, almost all the players will go to the cooperation committee I mentioned and explain why they want to do, and the others will say yes or no. If they all say yes, then you wait while they develop it, and you more or less start at the same time. On that basis, product innovation is quite rare. If you want to go and stand by your legal rights and just approach the Bundesaufsichtsamt für das Versicherungswesen (BAV), which is the supervisor, then you may say, "I want to develop this; please approve it; I do not plan to discuss this with the committee." You can do this. One particular French-owned English company did that with some variable products a year or two ago. It really upset a number of people in the status quo, but this English company is a tiny player, and they have to be different in order to try to succeed. They struggled a long time to get the necessary approval from the BAV.

MR. BUGG: Is it safe to say that with the tariff countries, there is a lot less product innovation?

MR. LOCKIE: Well, if you've got a strict tariff like Germany or Italy or Greece, for example, you can have a long wait to get approval from your supervisor. In the U.S. you may be licensed in 51-52 places, have a lot of communications and a lot of different people to talk to, but the process, as I understand it, is relatively simple. That's not necessarily going to be the case in some of these other countries. Nobody as yet has universal life in Italy, and one of the problems is the supervisory body doesn't really understand it. They would like to, but they don't really understand it, and until they do, they won't give approval. There are probably better ways of spending your time than trying to convince the supervisors of the merits of your proposals. Companies look to compete in other ways such as by expanding their salesforce but using the existing products.

MR. DONALD L. HAASL: I have a question for Mr. Dunn. Your description of the Japanese insurance industry surprises me. Poor quality of service, poor quality distribution, low productivity of salesforce. Is there something different about their management of insurance companies versus other industries such as electronics?

MR. DUNN: When I first went to Japan and was working within the insurance situation, I was a little surprised at the operation of the insurance industry. After some observation and reading, it finally dawned on me what the difference was. The Japanese domestic industries tend to be inefficient, whereas their export industries are very efficient. There's a big difference, and I think that's one of the things you see in the life insurance industry in Japan.

MR. GARTH A. BERNARD, SR.: In the tariff and nontariff countries, who do they perceive their customer to be? I know in the U.S. we have a divergence of opinion where some companies state that their distribution system is the customer, and others, on the other hand, will say that their customer is the consumer.

MR. DUNN: I think both are your customers. I think that if you regard the agent as your only customer, you're in trouble. However, if you don't view the agent as a customer that needs service, just as the policyholder needs service or as the client needs service, you're also in trouble. I think that complete attention to one or the other is a mistake. I think you do have to consider the ultimate consumer as being your customer, but also in terms of moving out of the central operation into the field, the agent has to be a customer also. The agent has to be served as well as your consumer has to be served. That might sound like a cop-out, but that's the way I read it. Incidentally, if I can come back to a previous question, it might sound like I was being very critical of the Japanese industry. I'm not at all. The Japanese industry has done very well within their structure, within what they're trying to accomplish, but in terms of a new company moving in there, you do have to be a great deal more efficient, and you have to operate differently. Prudential used to advertise itself as the largest insurance company in the world. We're a little humble now when we discovered that three Japanese companies are larger than we are. So, they're not doing all that badly.

MR. RICHARD F. LAMBERT: For Mr. Lockie, I want to understand the British industry a little better and how the taxation of life insurance works. In The Netherlands I can understand how you're selling high premium endowment policies to pay off mortgages because there's some tax leveraging, but I understand Britain has taken away many of the tax advantages of life insurance, and that seems to be a trend in the U.S. as well. Yet, we seem to have a trend towards lower premium contracts. The U.K. still has high premium/high profit products. Is there still any tax advantage to this linking of endowments to mortgages? Also, could you do it just as efficiently by putting your money in a mutual fund without the life insurance wrapper?

MR. LOCKIE: Yes, there were tax advantages on taking out endowment mortgages, but these are less now. Traditionally, mortgages were on a repayment basis, but slowly people became more aware of endowment mortgages. The tax advantages came from two sources. First, there used to be what we call premium relief on life assurance, which effectively meant that half the premium could be deducted from your taxable income at the basic rate of tax. Back in those days the basic rate would have been in the 30% range. The other source was full relief on the mortgage interest payments. In order to simplify the administration of the latter, the Inland Revenue introduced MIRAS (Mortgage Interest Relief At Source) whereby the borrower pays net of tax relief and the borrower gets the balance in a bulk return from the Revenue. In order to make MIRAS work more easily, there were some changes to the way the relief was calculated so that endowment mortgages became much more attractive. These external factors, plus the realization on the part of the lenders that there are some very attractive commissions available for recommending endowments (over 60% of the first year's premium), meant that there was a major switch to endowment mortgages.

However, the premium relief was discontinued for new business on March 15, 1984 -- a date that sticks in everybody's mind due to the complete chaos that reigned for a while -- and this meant that it's really now touch and go as to whether the repayment or endowment approach is better. A lot of people still recommend the endowment approach because, in theory, it can act as an investment, as well, if the return is better than assumed, but there is also the commission available.

In looking at alternatives there are variations on the theme. You can take advantage of the great tax reliefs that are available on pension products because part of the benefit there is a tax-free lump sum when you retire. You get full tax relief on the premiums, and there's a gross roll-up, whereas there's a net roll-up on the life premiums. So, if you can actually afford the higher premiums that are required for a pension policy, because you've still got to take a certain amount of pension, then that's a very tax-effective way of doing it. There are some of those around. Many people choose not to go that route, although it can be very tax advantageous if you pay higher-rate tax. As for using mutual funds, yes, there is a new system there. We have a thing called a PEP, a personal equity plan, for which you can invest modest amounts of money (it's about $8,000), and the roll-up of that is gross. You have to pay it out of your net income, but it rolls up gross, and you could perhaps use that to repay your mortgage. There are some of those available. A dangerous thing to do, in my opinion, because if and when we get a change of political party in power, that would be one of the first things that they may discontinue. Not many people are taking it. Many people are very conservative and take the traditional life endowment.

FROM THE FLOOR: I have two questions regarding conducting business in Europe. The first is for Linda Emory, and it's on more of a personal level. The question has to do with the difficulties and pleasantries of going into a foreign country, in particular a country where English isn't the mother tongue, and trying to live in that environment for a couple years.

For Mr. Lockie I have a question related to an idea he mentioned; companies in Europe, or maybe mainly in Germany and/or France, take a longer view towards return on invested capital because their investors are off in other businesses such as banks. Can you comment on that? And do you see that condition persisting in the longer term?

MS. EMORY: Basically, The Netherlands may be the easiest place to go that speaks a foreign language, because English is also spoken by nearly everyone. You can communicate without learning Dutch, and the people are very nice about accommodating you. I was certainly not the first American ever to work at Nat-Ned's home office. They've had a fairly long history of other American actuaries who went before me. The Dutch come over and visit their companies in the United States about once a quarter for a board meeting, so, I already had a working relationship with a lot of these people, and I felt pretty much at home with a lot of them. To be really honest with you, even these nice people that speak English very well prefer, in meetings with each other, to speak Dutch. So, there is sometimes a feeling that you're a burden to them. There's a little feeling of being an outsider. I wish I had learned to speak Dutch better. The advantages that I was given to see the world through Dutch eyes certainly outweighed any minor disadvantages.

MR. LOCKIE: I'd just echo a comment about the English. There are some countries in Europe where English is very widely spoken. The Scandinavian countries will all speak English to you quite happily. There are one or two international Swedish companies, such as Electrolux and SAS, the airline, where all internal communication is in English as a standard business practice, because they recognize there aren't many people in the world who are going to learn Swedish, but they'll learn English.

FROM THE FLOOR: For both you and Ms. Emory, do you feel removed at all to the extent that at least parts of meetings must be conducted in a foreign language or is that not a real problem?

MS. EMORY: Well, when I went to our domestic Dutch company one time to work on a special project, even though those people didn't normally conduct things in English, and all of the meeting notes were in Dutch, they still accommodated me. We had the meetings in English, which I'm sure was very difficult for them, and if I needed any help interpreting the notes, they were more than willing to provide it to me. All of our official international correspondence is in English. So, yes, you obviously are imposing on people, but they accept it very willingly.

MR. LOCKIE: I'd just add one comment. If you go to some other countries where English is not widely spoken and you're going to be there for a while, make a big effort to try to learn a fair amount of the language. I know of one of my competitor reinsurers who speaks perfect German, yet every time he goes to Germany for a meeting he says, "Let's speak in English, it's the second language for both of us." He never lets on that he speaks perfect German. He says you'd be surprised what you learn when they're speaking in their native tongue, thinking you don't understand them. That's a concrete example, and I'm fairly convinced it's happened to me in other countries as well. If you're there for any while, try to learn to understand what's going on around you, even if you can't pick up the finer details.

MS. EMORY: Just one more comment. Actuaries have an advantage in that the formulas and numbers are the same in all languages.

MR. LOCKIE: There was a second question related to the longer-term view. It's difficult, really, to answer this one simply. The U.K. and the U.S. have some very advanced stock exchanges. For public companies you can buy in and sell out quite quickly. The investment analysts are always looking to see the good deals and the bad deals and make advice accordingly. Much of continental Europe does not have an advanced stock exchange. Germany is starting to get quite a large stock exchange in Frankfurt, but not a lot of business is actually transacted there. Much of the stock is held by banks. You don't have stockbrokers as such; you go to a bank to try to buy stock.

The whole ethos of much of these countries is a much longer-term view. They're very happy to take cross-shareholdings in each other and learn from each other's experience. If they feel happy with that situation, they'll take larger cross-shareholdings and maybe even one day merge. If they find they don't really like each other, or they're going in separate directions, they'll divest those cross-shareholdings maybe to somewhere else. It's a very different atmosphere perhaps from the one you're used to here. I really can't explain it in a nutshell. It's just the way they've traditionally developed their companies, mostly on the back of bank loans rather than going to the market with a flotation, and that has produced a different feel.

MR. BUGG: Mr. Dunn, do you see or have you seen the same sort of thing in the Far East, that their business horizon is much further out than in the U.S.?

MR. DUNN: Definitely, and I think that that's one of the advantages that the domestic foreign companies have over us; their time horizon is much longer than ours.

MR. JOHN W. HADLEY: Mr. Dunn, you mentioned that the Japanese insurers tend to be less efficient because they're a domestic industry. As they buy U.S. insurers, or expand into the U.S. marketplace, do you see that changing rapidly and affecting how they operate both in Japan and outside?

MR. DUNN: Good question because I think that's happening right now, particularly Nippon Life who is very interested, I understand, in moving into the United States. They have a great deal of financial clout. They have been working internally in their Japanese operation. They've been working with consultants. They have made many changes. They'd like to, I'm sure, make more. They, again, have a structure, and it's going to take them time, and it's going to be difficult to change, but they're going to be here. Dai-ichi Mutual Life is another company that I feel may be interested in the U.S. market. The Japanese insurers are learning, and they're becoming much more efficient in their investment operations. The investment operations in the Japanese life insurance companies, and they will admit this, historically have been very weak. They are changing. That's why they're buying into some of the U.S. investment houses, to learn. They're coming. So, be prepared because they're going to be tough.

MS. CATHERINE PRIME: I'm a consulting actuary from Australia. I wanted to offer my observations regarding the difficulties associated with big business across different languages. My personal experience is further south in Asia than Mr. Dunn's, I suspect. It would be the most southerly Asian countries and Australia. Language is a difficulty, but I think it's wrong to use it as an excuse for all the problems one might have, and I must agree with what has been said by several speakers. U.S. companies have many virtues, but perhaps one of them is not patience; you need patience very much. Maybe the further south you go, the more patient you need to be. Indonesia, particularly, might be as far south as you can go. But patience, a sensitivity to local conditions, and a willingness to spend time on developing relations with the local regulators is very important. Language is also important, but don't think it's only language. It's often these other things. Also, I would say that in Australia, particularly, these qualities are the reason that the European companies have been relatively successful compared with U.S. companies who are currently in a state of withdrawal.

MR. DUNN: I agree. If you want to see an unsuccessful American in the Far East, watch somebody that behaves like the aggressive American businessman. They're dead before they start. They're dead in the water, and we have seen people operate that way. You're quite right. Also it is a little humbling, incidentally, to be totally illiterate.

MR. SAUL CHANAN GOODMAN: I have a question for the panel on their attitudes and experience in establishing joint ventures versus setting up their own operations.

MR. DUNN: Having been involved in both, I perhaps can answer that. I would counsel against a 50/50 joint venture. We started our first operation as a joint venture. We are now going all the way on our own. We sold our interest in the joint venture to our partner, started our own operation and now both companies are very pleased and happy with the results.

MR. ANDRÉ CHUFFART*: What is your experience in having access to the top executives in countries like France or Germany? Is it easy?

MR. LOCKIE: I don't know. How easy is it for you, Mr. Chuffart?

MR. CHUFFART: I would say my impression is that it is easier in the States than in some European countries, particularly France. When I call from Europe, for instance, I usually do not have too many problems getting in touch even with high people here, and I would suspect that if you tried to get in touch with the president of a French company, you can be ringing a lot.

MR. LOCKIE: I'd echo that. I personally don't have much experience of dealing with France. It is a lot easier for you and me to get in touch with chief executives, say, of an American company because of the time difference. We can be at our desks at two o'clock, three o'clock, whatever the European time is in the afternoon, feeling quite happy. He's just staggered into his desk at eight o'clock searching for his first cup of coffee. He isn't awake enough yet to say no. That may not be the case, but it's certainly a lot easier to use that time difference for me to get in touch with ladies and gentlemen such as yourself. In some of the European companies the top people are much more protected and are much more reluctant to meet outside people. It's a question, really, of just chipping away, as I suspect you know, but I've found it varies between European countries as to how open or how welcoming they can be.

MR. BUGG: Mr. Dunn, you used a term in your presentation, "conventional wisdom," and I was going to ask you to elaborate on what you meant by that term.

MR. DUNN: Let me come back to my experience to help explain that. When we moved into foreign countries we talked to people in those countries. We talked to people in the industry. Of course, they would prefer we didn't come there, so you take a little of what they say with a grain of salt. However, I'm convinced that in most cases they believe what they are saying. For example, in Japan, the domestic distribution

* Mr. Chuffart, not a member of the Society, is Vice President of Swiss Reinsurance Company in Zurich, Switzerland.

system is mainly housewives, mostly working part time. We wanted to go into Japan with a highly educated, all college-graduate salesforce, starting off with a male salesforce. They told us that was impossible; that you could not attract those people into the industry, and that you could not get those kind of people to work on a commission. This was obviously false because we have done it. They told us that there was no market in Japan for whole life insurance because people would not buy whole life insurance. When we moved there, sales were approximately 90% endowments with multiples of term. Today whole life accounts for over 25% of the market.

So, you go down the line, and people within those countries will tell you how people will behave. They'll tell you how the consumer will behave. They'll tell you how the employees will behave. Sometimes they're right but not all the time, believe me. I think it's important, if you're thinking of moving into a foreign operation, to do your own research as well as take advantage of the research that is done within those countries. Our discovery was that the Japanese use their research about as well as we do here. Every three or four years they have a major financial survey in Japan. Now, it took us a long time to get all of that translated, but it was invaluable; available to the Japanese companies, but they tend to ignore it, as we tend to ignore the research that's done here. So, really, things aren't any different, but it is important for you to independently measure the marketplace and measure the objectives that you have and what you want to put in place. That's what I meant.