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THE MARKETING FRONT

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H. MICHAEL SHUMRAK
Recorder: THOMAS M. MARRA

- Demographic trends and impact on products
- Market research
- Market segments
- Distribution

MR. THOMAS M. MARRA: To me, the essence of marketing is customer generation and preservation. We're all in business to serve customers. That's the slant that we're going to take. The term *marketing* means a lot of different things, depending on whom you're asking. I'd like to think of all of us as performing in marketing roles.

I happen to be a little fortunate. I work for ITT Corporation, which operates in many noninsurance businesses. We're big in the automotive industry and the defense industry. We own a paper manufacturer and Sheraton hotels. We used to be in telecommunications. So, I get a chance from time to time to spend some time with the executives from other parts of this conglomerate. I find that when they talk about marketing, they tend to think of things differently than the way I would say insurance companies view marketing. Marketing in insurance companies tends to lean towards distribution or maybe promotional activities around distribution. But, I'm not so sure it's the strategic focus that I've seen in some of these other industries' marketing act. I think this is our challenge.

The definition of marketing that I'd like to use is "the art or discipline of developing and retaining customers and customer relationships." Everything that an enterprise does needs to be surrounded around that customer. Quite simply, customers are our profits. To attract the customer, you need an integrated strategy, a differential advantage to provide something that customer needs and wants and that he can't get anywhere else. That's the essence of marketing, and probably the essence of business.

If you think of any successful company in any industry (Wal-Mart, Disney, Home Depot, etc.), you'll find one thing in common, happy customers. The companies that are providing a differential advantage to their customers are the companies making money.

We're going to get into some of these issues of customer creation and retention and what that means to us as business people in the art of marketing. We have two speakers and then we're going to open up for general questions. The first speaker is going to be Mike Shumrak, who is a consultant with Tillinghast who specializes in marketing. So, his clients are both actuaries and other parts of the business enterprise. He helped to organize the Society's Nontraditional Marketing Section

* Mr. Jameison, not a member of the sponsoring organizations, is President of Fidelity Investments Life Insurance in Boston, Massachusetts.

and served as it's first Chairperson. He has authored the SOA study note titled "Pricing Direct Response Insurance Programs."

MR. H. MICHAEL SHUMRAK: I'd like to set the scene in terms of some interesting things going on in the marketing front by first going over some of the bad news in terms of the so-called distribution crises and then explaining that, with all the effort and concern over the last ten years, at least, on the part of most of us, there really hasn't been tremendous improvement or some magic formula that's turned things around. Then, my closing remarks will be a description of a number of concepts and practical applications of technology and of a different way to look at the business that might help put us back on track. I think that should set the scene fairly well for Rich, who will give us a basically live and actual example of how some of these things are actually already in place at Fidelity Investments.

The primary focus of my comments is going to be more aimed at what we call individual retail markets and distribution systems as opposed to true group and institutional investment situations, although some of the broadest concepts apply to those businesses as well. So, to start out, let's look at the product situation. We start out with a conventional line of business framework. But, the way I want to set the scene for what the problems have been is by thinking about individual protection products -- the health product is all protection -- life products, think of universal life and whole life as savings products that also offer protection, and think of the investment products to either be single-premium life products or annuities or products where the primary sales situation and motivation of the customer is savings.

Historically we made a lot more of our money on spreads and investments years ago and also in mortality gains. With the advent of the universal life products all of that has changed in terms of the risk profile and our ability to maintain mortality spreads. So, in terms of making money on holding assets and making a spread on interest we've been in steady decline except for the last five years, which I'll get to later. The banks and the thrifts have really been in decline and then the investment companies, firms like Fidelity and others, have really taken off from the mid-1970s in terms of their market share of personal assets held.

Coming at it another way, not so much as a shift in terms of assets, but in terms of premium revenues and looking at those lines of business/sales situations, descriptions that we started with, the individual life and health protection lines have hardly grown at all. The same is true for individual savings and most of the growth in individual products has been in the investment products, which is mainly the annuities. Of course, in the group sector of both the investment and the saving things have grown.

Focusing on the life industry share of the personal savings where we had that steep decline, but seems like it's rebounded over the last five years, most of that has been due to the investment business and the sale of the annuities. If we think about it, a fair amount of those investment business annuity sales have come not from traditional distribution systems and traditional customer sources, but from financial institutions and other nontraditional sources and distribution channels.

Taking a look at it another way, let's look from a capital management point of view and where we're investing in our new business. Again, the individual savings

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products, which are basically whole life and universal life, and even the term life, have dropped substantially in the last six years. The health has grown a little bit. But, I think part of that is long-term care, and of course, the individual protection has grown tremendously, which we're talking both capital consumption and also with how our capital is being used and where the business is headed.

The issue is that we're losing our savings market share where we made historically reasonable gains on investments. We're not growing the premium income. So, even gains on mortality aren't what they used to be and to meet the competitive pressures in today's marketplace, particularly with a lot of products that are driven by illustrations, if we truly risk adjust the assumptions for the risks of the products, the cost of the capital, and so on, a lot of the new business, if you measure it that way, is probably adding no value at all, and it's being masked by the renewal profits on the in-force business.

Probably the most telling statistic of the problem of the lack of productivity is the number of sales of individual life. That's individual life sales in millions, and there has been a steady and significant, even over six or seven years, decline in the number of sales made. With respect to the focus, which is how do we get closer to our customers and develop longer-term relationships, I think the statistics for how many policies are in force divided by the households for most companies is hardly greater than one, maybe 1.1 in many companies. So, not only are there not many sales made every week, but also despite the proliferation of products from our insurance companies and our sister companies, if they offer investment and other products, it's still sort of a one sale at a time business.

Cutting against that, of course, we're having the more rigorous capital requirements. So, there's even more pressure on pricing and managing the capital. Even if we were paying attention to our customers over the last 10 or 20 years, who they are, what they want, and their sales situations are shifting due to a combination of the aging, lifestyles, shorter marriages, smaller families, more dual working spouses, being better informed, and so on. Years ago there weren't that many alternatives. If you were looking for death protection or health protection or guarantees against certain risks, you didn't have that many alternatives in terms of who you would go to or talk to. Now, there are many. You've got banks, investment companies, and other organizations offering products either directly or through joint ventures.

What we'll see as the key factors influencing the marketplace in the 1990s the more rigorous capital requirements, which means we really have to think of ways to acquire and keep our customers on a more capital efficient basis. We have to recognize the lifestyle, educational, aging trends. The competition from the low-cost alternatives is even worse as we have the continued threat of possibly losing the inside buildup as well as banks continuing to push to be in the business, which of course, they can be in terms of distribution.

In terms of the customer marketplace, again, we have the baby boomer generation. These people are going to be shifting from net spenders to net savers. So, there's an opportunity. But, if we're not positioned strongly, as we saw before, for savings and investments, our product offers aren't going to be that attractive. The short-term sudden death protection requirements aren't as great because of the dual working

family with shorter marriages. So, the concerns are more what I might call survival protection, which might be better for disability income, long-term care, and certain other survivorship products, which might tie to things like being sick or having benefits tied to a living income and assets that are declining.

Clients are going to be better educated. So, the sales process has to be different. They're going to be more knowledgeable. They're going to tend to want the salesperson to tell them, here's what the situation is, here's what your alternatives are, and here's the different things to consider. A lot more of the clients are going to say, I want to think through the decision; I want to make, rather than be lead or pushed into one. Otherwise they won't buy, unlike the traditional model.

Bringing it down to a practical example, compare the savings and investment function of investing \$2,000 a year periodically over the years, say for 20 years or so, in a life insurance product, an annuity policy, a bank CD and a mutual fund. The life policy profile is based on a expense study we do with about a dozen or more mutual companies, as well as other information we gather publicly in terms of marketing costs and maintenance costs and that sort of thing. So, it's a reasonable profile of the industry. It's the same for the annuity policy. The operating cost ranges, therefore, are based on those types of assumptions for the life and the annuity policy. Again, for the life policy the first-year total cost, commissions, and other marketing processes may be about 160%, maybe \$45 for policy cost, 15 basis points to manage the investment annuities, which is probably about a 77% expense cost. Then, you have the cost of capital where again, simplifying the maybe reasonable assumptions, I think 5% or so of assets as the required surplus and target from the low to mid-teens in terms of return on equity. Then, carrying through the 20-year tax advantage of this inside buildup for savings and investment the life policy possibly competes with the bank CD and the annuity is competitive with the mutual fund. But, again if you take away the tax advantage, it falls by the wayside.

So, again, thinking of it that way in terms of high and low cost intermediaries, it's not just a matter of more marketing emphasis by the mutual fund organizations, but it's also a matter of being a lower cost distribution system and being more focused on customers. You can see the reversal in the personal assets held by intermediaries where, if you characterize the high cost intermediaries as the commercial banks, the thrifts, and the insurance savings, which means more like the whole life, universal life and then characterize the low cost players as the mutual funds, no-load funds and the more competitive insurance accumulation products, you can see what's happening.

As far as solutions, I'll talk in terms of a framework. I think the first thing is we see in the press and we hear from companies a lot more talk about focusing on customers rather than products and on markets rather than sales and on capital management rather than just on the distribution system. One of the first keys is organizing around markets, which Tom mentioned and I think Rich will describe in more detail. But, aside from the sales department or the marketing department or the actuarial department where the people develop the products, it really goes across even your service areas where, if they're doing what's called quality service or more expensive service, that should be more expensive because it's been proven or tested or researched. But, it's more valuable from the customer's point of view. You'll find the same thing with

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all the product development efforts. Let's develop things from the customer's point of view.

Proprietary database and strategic use of information is a key ingredient. The idea is that a lot of the data we have from our business are transactional. We know what we need to know to build customers and do our financial reporting. But, if we wanted to say, well, how many relationships do we have with a customer and how efficient is it if we sell more than one product to a customer, it's a massive data-processing job. But, with today's technology, both in hardware and software and the right kind of process there are opportunities to use information strategically to understand the customers you already have: which are the most profitable; which aren't and why; and of the better ones how can we develop marketing planned products and aim our distribution systems to go after those and not after the others?

Consider financial performance measurement. We have so many other measures and I'm reluctant to say that, but I think it's important. We really do need a measure, even if we still have to do statutory and GAAP and returns on required surplus and all of that. We really do have to have a measure that's relevant to the marketing situation and lifetime customer value. Measuring that, managing that and tracking that I think is the way to tie capital management pricing and the market-driven paradigm.

Finally, consider a lot of the solutions to the distribution crises. Maybe it's cheaper if we distribute through direct mail or other methods. I've got to tell you if you're going to get a new customer through the mail, using a list of people you don't even know and make just one sale, that isn't any cheaper than most agencies full of business. It's certainly riskier because you may not get anybody buying. So, the key is, you really have to step back and not say you're a direct marketing company or an agency company, but, you're a market-oriented company. You're going to either have or develop various distribution approaches so that at each stage in the customer relationship you use whatever method is best for the customer and the most capital efficient from your point of view, rather than being locked into one situation because of the nature of the group doing the distribution.

Again, the client-focused organization is looking from the outside in rather than looking at the company's functions and saying, let's have the most efficient issue process. It has to be the most efficient issue process from how the customer looks at it, which might result in a different process and different value structure than the way we look at it in terms of trying to drive down the not taken ratio or just trying to drive down how fast we underwrite. There are big differences in terms of the viewpoints. A lot of the products are developed in terms of if we were buying it and this is what we would want and we really have to get away from it unless our market comprises actuaries like us.

Consider the complexity of the products. It may not be across the board, but a lot of the product complexities have really been developed with the illustration-driven marketing to mask the high distribution cost and the lack of guarantee, so the customers still think they're getting a good deal, but at the same time we're able to price in the distribution costs we need to pay the marketing costs we need, and so on. Again we're saying, let's get the product and see how much we can sell, rather

than saying, what do the customers want and let's just give them what they need. Product development takes time and it's expensive. But, there are real advantages to spending a little extra time and customizing products, looking at not only the customer segment, but also the stage of the customer cycle and the sale situation.

People ask me about the more interesting or different products I'm working on. It's not some product none of us have ever heard of. It's more taking a product we all know and just rejiggering it in terms of how we present it and how we mix and match the rates and the benefits or even the purchase process, in terms of how we're going to build the products or what the customers can do after they buy the product. There is a lot of leverage in that and not a lot of investment. For a product line of business, we have to do things organizationally for regulatory requirements. But, the organization for financial performance measurement and working together should really be tied more around the markets and the customers.

One of the areas where there's already been some success for some companies is applying database marketing to the process of prospecting. With one sale a week and with the very low agent retention levels and the 1.1 sale per customer, using the database approaches with a definition of specific markets, the company can work with the agency system to much more effectively identify those best customers and tee them up for the distribution channels, for the agent or if there are other channels that make sense for those other channels. These products have tremendous leverage, tremendous benefit right away. The real big benefit later on – it would be an evolutionary thing – is that once a company would substantiate that it has taken over most of the prospecting function efficiently, cost effectively, then the face to face sales force is mostly closing sales, not trying to prospect for sales. So, a few of the agents failed more productivity, and then presumably the equation in terms of the commissions can slowly be changed because presumably they're paid the commission to both prospect and close. If the agents are no longer having to prospect, maybe there's an advantage for everybody by having a more competitive product offer with a different commission structure where the producer still makes as much or more money.

We already talked about repackaging. Again, it's taking your core products and not saying they aren't any good or they're outdated, but, let's look at them in different ways—arrayed against our client segments and arrayed against our sales situations and the stage of our life cycle with our customers. All this information is tracked through the marketing database. The marketing database isn't a magic software. It's a process that takes a lot of hard work and a lot of attention and a lot of teamwork from the field and the home office. Integrated into that is not just sales and marketing stuff, but economic stuff in terms of how profitable are the customers versus the assumption we made to acquire them.

What you'll find, if you get the market-driven paradigm understood across all the functions is that there will be more natural teamwork with the various disciplines instead of fighting at each other, for example, on the mortality assumption versus the underwriting costs versus the marketing results. You'll find that all of those will be integrated. After the fact, they all have to be sorted out because everybody has to do their job. But, the marketing strategy decision is made on a balance of what are we doing in the market, and at the same time are we balancing underwriting

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framework versus underwriting cost versus expected claim cost by combining that marketing strategy with that underwriting approach.

As you implement this cross-functional market-driven approach, the lifetime customer value or certain other measures of value are very important -- because to really get quantifiable progress information on how all this is working across the company most of the traditional measures of statutory and GAAP don't really help you. You really have to say, if we're trying to acquire customers who are profitable and valuable, how have we done each point in time across all the functions, and if we're investing in superior systems or service, what do we spend on that now and what's the present value of the return on it and how are we sharing that with the employees?

I think we've already described database marketing. It's a process, not a system or a piece of data. It's a continuous process of using technology to understand your customers so that you can take leads, qualify them, make them buyers, but then go beyond. This is basically where we stop, with the buyers. We want repeat buyers, and then we want to watch customers who are real because of our brand recognition, because of what we do for them, and who would be more reluctant to switch.

The process is continuous with feedback groups. You set a strategy. You execute it. You see what the response is and what the results are. You analyze it. Our premise for acquiring these customers was A, B, and C. A and B worked fine, but C premise was a little bit off base. You fine-tune and cycle through again using the marketing database and adding to it each time you're trying something.

From an actuarial point of view, a lot of how this is done is by using both statistical technique and modeling of behavior buying patterns, using predictive models, who will buy, who will stay, who will buy more than one product. So, it is fairly much statistical application and not just pure marketing hope that the marketing database drives from.

Consider the definition of lifetime customer value. Look at each customer within a marketing customer group and say, well, looking at the risk and the cost of capital and the opportunity in that market, what is the value of the customer relationship. Is it worth acquiring that customer, or if it's an existing customer, where do we stand now and how much more should we invest or how much more should we try to reap from that customer?

The discount rate is fairly traditional, looking at the cost of capital, looking at the timing and risk preferences of the company, of the stockholders. Conceptually, the way I look at it is lifetime customer value, sort of tying it to the historical thing of getting market shares. Suppose we're doing the female market and we want a 30% market share. Well, how many of all the customers do you have? Market depth within that female market, how many financial products and services can I provide? How much will the person need? How many of them can I provide, either directly through the products I offer or through strategic alliances with other organizations? If you provide and the product and I maintain and control the customer relationship, I can make money on the equity ownership of my customers, or vice versa if I have the product, but not the market. So, I think that's an important thing. The old

paradigm was the sales-focused goal where, if you just got enough critical mass, you'd make it. But, if you look at a lot of the risk-adjusted returns on new business, even if you keep adding agents and even if you keep adding sales, in a lot of situations it just isn't going to get you there.

If you can sell more than the one product and leverage the relationships, the marketing costs for the second sale or the third sale aren't as great as for the first. Increase agent retention by having them better positioned with prospects, then you're doing the relationship-focused marketing where you both aspire to a high market share, but even if you don't get it, you've got a high market share of each customer.

The performance measurement process is really important. You want to link your marketing strategy with your marketing results and to your pricing. Some version of this lifetime customer value approach is one that does it.

My final thought is integrated distribution -- it's a big distinction as opposed to saying, we're going to be customer oriented and we're going to have some supplemental distribution, but all those are separate businesses. The better way to look at it is, let's look at our customer situations and segments and what they need in terms of distribution, and position that accordingly. This might mean not only more than one type of distribution, but also not using them in separate boxes, but integrating them based on the first sale. You got it through a direct marketing of an annuity product through a bank, but then the next sale might be a long-term-care sale where a specialist face-to-face sale runs the relationship.

I guess what we're looking to do in the final analysis on a simple basis is to be able to make the right offer to the right person at the right time through the right channel, because if you're doing that, certainly distribution paths, productivity agency retention and company process are all going to go up.

MR. MARRA: That was an excellent presentation. I love the concept of lifetime customer value, and we try to think that way. Customers are profits, and to use our tools as financial analysts and some of the abilities, we have to focus on how much profits we are getting from each customer. This helps to really bring home what the value of that customer relationship is. I thought that was well articulated.

Our next presenter is Rich Jameison who is president of Fidelity Investments Life Insurance Company right here in Boston. Rich is a guest of the Society. That means he's not an actuary. He has been in the insurance business for some time now with Metropolitan and Prudential, and then he's been heavily involved in the equity side of the insurance business with Monarch Resources as its chief marketing officer and then as national sales manager of Fidelity up to his current position of becoming president of Fidelity. He's going to talk about Fidelity's strategies and its multiple distribution outlets. There's one operation that has, I know, taken some painstaking efforts to get to know the customer quite well. He's going to present some of that information.

MR. RICHARD D. JAMEISON: I may not be an actuary, but in my last two positions I had the opportunity to work first for Jerry Golden, who is an actuary who didn't

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want to tell anybody he was an actuary and then Rod Rhoda most recently, who is also an actuary.

I was at a meeting recently and I heard something that I think maybe best summarizes what the Fidelity is, and the quote was "a prospect is a statistic and a client is a person." That's somewhat out of context. But, I would say what makes Fidelity very different is the fact that everything is run around a service focus. I'll show you as I go through this how we don't get judged only on whether or not we have a good product necessarily, but we are judged as much on living up to Fidelity service standards, up to and including how quickly we answer a client's telephone call.

I really had two lives in the insurance business. I started just about as traditional as you can get. The first half of my career was split between the Metropolitan and then subsequently Prudential. I grew up first in a company going out of the debit business and then eventually became director of marketing in a company that was totally wedded to the debit business. It was a very different kind of a scenario. Then, I had the opportunity to work for Jerry Golden at Monarch and deal with stockbrokers, which was about as opposite of my experience as it could be. Our biggest concern in dealing with stockbrokers was they wanted quick underwriting because, if you couldn't underwrite a product quickly enough, they wanted to buy bonds. I mean, it was totally different.

But, what's most unique about Fidelity is Fidelity has really been able to integrate a very solid client base and offer quality products to that database, and that's exactly where our business comes from. I think everybody has a good idea of what Fidelity is. But, it gets bigger every day. Fidelity has nearly 200 individual mutual funds, over \$200 billion on their assets. But, the next two statistics are really what drew me the most to Fidelity and what has turned out to be a big part of our success, and that is there are over 2 million households and 1 million IRA clients.

I'll talk more about that as I go through. But, can you imagine having grown up in a traditional insurance business, then having to deal through stockbrokers to inherit an opportunity to cross-sell a Fidelity client base where each of those clients are very happy that they're with Fidelity? I mean, that is the ultimate opportunity of a lifetime. The other thing is that the average fund account balance is \$17,000.

Our distribution channel is small. In fact, within the insurance group as a whole, which represents two insurance companies and seven individual agencies, we only have 100 people. But, our distribution is split between phone and face-to-face roles. On the phones, we have 22 sales representatives. Each individual sales rep averages, and this is variable annuity premium, about \$10 million per rep on the phone. We have about 75 investor centers, 350 registered reps, these are the individuals who make this very different. In Boston there are two or in Los Angeles there are two, and then there are lots of places where there aren't any registered reps. For example, if you were to go into a Fidelity investor center and go up to the counter and make a deposit into our investment product called Asset Manager, the odds are the individual on the other side of that counter is a broker, unlike dealing with Merrill or the traditional firms where you would go in, where you would pass money through a cage. In those cases it's a clerk on the other side, and the very next day the transaction shows up on a broker statement.

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I learned assets under management in terms of a broker's mentality in dealing with Merrill, and it is exactly the same philosophy that we have taken at Fidelity, which is the more pieces of an individual's investment portfolio that you have, the more quality product that you can provide and the better the long-term relationship.

We're taking the client base, targeting the segment that is greater than 45, a multiple fund owner, and then the third part is a retirement saver, which is what we direct most of our direct mail marketing efforts at.

These are statistics from 1992. Obviously, we got a number of letter inquiries -- an inquiry is somebody who calls or writes in. We made a fairly big strategic change back about two years ago which was frankly a major departure for Fidelity. If you were to get an advertisement or solicitation, most times within Fidelity you could send in either a card or a letter and say, send me information on one of these products. So, when I first came to the Fidelity, we received leads on people who had inquired that in turn had to be followed up on. Well, it didn't take us too long to realize that 97% of the sales that were made were from people who called us, and 3% of the sales were made from people whom we had to call. So, you had people looking for information as compared to buyers coming in.

We made a major departure two years ago. As far as the annuity products are concerned, which is the primary portion of what I'll speak about, the only way that you can get information is call, talk to somebody on the phone who will screen you, and then we'll send the information. We saved a tremendous amount of money because as I said, 2% or 3% of all the people bought that sent in, and we were sending out these kits that cost \$3 or \$4 or \$5; it was absolutely not efficient. We made the change, saved money, and our numbers went up. So, we forced the call. We have about 3.8% of what we mail inquire -- that means they call. Of those, 67% are sent a kit. In other words 33% are qualified on the phone to determine that it really was not the right product. About 21% will buy. I took the cost of a new account, divided it by the size and got about \$2.5 per dollar of premium that we get in.

If somebody had ever told me when I first came in the business that we would get an average of 440 calls a day from people who say, I think I'm interested in buying something, to this day I don't believe it. But, our core volume has gone up dramatically, and I'll show you why people call. Over 400 people call a day. They talk to a fully registered, fully licensed individual on the phone. Direct mail solicitation is why people call. To illustrate cross-sell, suppose they call in, and ask about Asset Manager. One of the reps on the phone, who would be a mutual fund rep, might say would you want that taxable or tax deferred. The rep would do some basic fact finding to find out if the prospect has short-term dollars or long-term dollars. If there's any interest and possibility of a retirement-oriented sale, the rep will switch the request over to what's called the insurance gate.

Publicity doesn't necessarily have anything to do with us. It's kind of amazing. Fidelity is perceived as a low cost, quality product provider. Many, many times clients will call us and say either my broker introduced this or I read about this in the paper, do you have something similar.

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We've come a long way on sourcing. This is the average day for one of those individual reps on the phone. They would take 44 inbound phone calls. These are new people who are calling to talk to an insurance registered rep for the first time. Then there are 30 follow ups. There's another thing about Fidelity. Whether it's a broker in the individual center or whether it's somebody in one of the three phone sites around the U.S., we never make an unsolicited phone call. It's truly unbelievable.

A contact is somebody who goes on to the next level. So, in other words about 50% of the people there that call in on a daily basis are either screened out or guided on to some other product. So, our contact is brought to the next level, in other words, interested. We average about seven contacts from the 30 follow ups.

The difference between the 30 and the seven isn't necessarily that 23 fall out of the follow-up system. When you're making a follow-up call after somebody has requested information, they may not be home, you may get an answering machine, so, it's not necessarily fallout per se. But, we try to manage around 30 follow ups per day. That is what we look for the reps to do.

This is activity during that day. We made another major change. When I first went there, it was really a very reactive process. In other words, there were not very many questions that were asked on our side. It was reactive, which is how the Fidelity had always been – respond to the questions that the client had. It was also interesting that the people whom we had in those days, for the most part, had no sales background. They came off the mutual fund phones. Over the last five years we've made a change and look for individuals to have more sales orientation, and teach them to ask basic fact-finding questions. Another thing that was actually a very difficult thing for us to accept or actually for me to accept was that we tried to get the reps to complete an application on the telephone. I remember in the beginning the opinion was that nobody will ever do this. Fact is that it was positioned as a service, and if you ask enough times, reps ultimately do it. But, now that is a critical part of our strategy. If you can imagine sending out a prospectus, product explanation and a brochure, and an application and expect that client to fill it out, the odds are, first he or she won't do it and second, if he or she does, it would be wrong. So, we have absolutely positioned application completion as a service where we would say, it's relatively complicated; there is no obligation; we can help you complete the application. We also built a computer system where the data are keyed into the system and the application goes out automatically. Integrating this with a computer system is critical. If you can imagine sending out about 60 some odd applications a day, that is a lot of applications to complete. But, the system prints them out fairly quickly.

We send out 23 letters, and we try to confirm everything we've done in a letter, and about 22 kits. The average length of a phone call, in other words, how long you talk with a prospect, is about 12 minutes. We find the longer the call the better the close ratio.

Conversions are also known as people who buy. Of those people who buy, and again, this is purely on the phones, we average three conversations. You have spoken the first time they called in and made two follow ups. One time we sent a

letter, it's actually a little closer to two. It takes 54 days for that individual to buy. The last statistic, which is getting bigger month by month by month, is 57% of those people who buy we did an application for. That was maybe one of the more significant things that we did, and the nice part about it, we know it's right when it goes out.

How do we do business through the branches? I said before that one of the ways is, when you get walk-in traffic where an individual would come in and make a deposit, cross-selling at the counter is absolutely something that generates business. But, I learned when I was dealing with the Merrill system and the variable life product that we had, more of our business came directly or indirectly as a result of seminars than anything else that we did. So, seminars are a critical part of what we do. We utilize for the most part the Fidelity client base. Those clients are screened, and we send them an invitation to come to a tax-deferred retirement seminar or some topic along those lines. We tried a mailing at the end of 1992 that asked, How would you like to come to a seminar on annuities that reviews the advantages? We've done 58 of these seminars. We mailed about 116,000. We basically take a trading area and send 2,000 letters into that area, to a selected group of the client base. About 2.3% of the people come, and of those that come 10% buy. Cost of acquisition is 0.7%. It's unbelievable.

We also developed a strategy when we first put the organization together four years ago that is in the second stage of implementation. The idea was accumulation, which is a variable annuity, utilization, which is an income annuity, and transfer, which is taking those assets and maximizing the benefit to the heirs, which is estate planning. Remember accumulation, utilization, and transfer. Then, the loop starts right over because you're dealing with the heirs who in turn have the dollars and you accumulate.

There are 55,000 people within the Fidelity client base whom we estimate to be potential estate planning prospects, and this is based on what demographics we had in terms of the value of dollars they had with us and the percentage that we assume they have overall. We repiloted six seminars on this topic. We mailed almost 3,000 invitations for each. We had 14% of everybody we mailed come. We've had 42% come with appointments, and 60% of those went through the fact finder. That doesn't mean that 40% were not interested. That means that 40%, some of them were not interested, but many didn't hit the \$1,200,000 and other services were offered. This is relatively new, but that is the third stage of this strategy.

Consider a buyer profile. Who buys? Seventy-one percent are Fidelity clients, and I always say, well, that's great, where did the other 29% come from? Sixty-six percent deal in a branch face to face. Twenty-three percent deal on the phones, and about 10% go to the branch, go home, read something, call in on the phones or vice versa; they'll call in on the phones, and ask, do you have somebody local whom I can talk to?

Regarding distribution, when I first went to Fidelity in 1988, 100% of the business was done on the telephone, and you'll see later in the statistics most of that was variable life insurance. In fact, Fidelity had sold a Monarch product at the time, which was a single premium last-to-die variable life policy that was sold on the phone. That

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was not one of the products that I was responsible for at Monarch. I had the stockbroker distribution. But, I went there knowing that Fidelity had this opportunity to market through the investor centers, in addition to the phones, which was frankly what my expertise was. I didn't know anything about marketing on the phones. But, we have over the years changed the distribution dramatically. The key is that both have grown. It is not that one has replaced the other. Last year, in fact, we did over \$200 million on the phones up from \$30 million in 1988. But, the total of \$671 million was our total premium for the year.

The numbers here get a little fuzzy because of the fact that this is not double counted. But, you remember I said before 66% buy in the branches, 23% buy on the phones, and 10% overlap? That overlap could become a conflict between branch and phone reps. We didn't want the branch rep and the phone rep fighting over that case. So, we designed a compensation by reducing compensation on each of the parts to make sure that on the 10% we paid both. The last thing in the world we needed was a phone rep saying, deal with me and a branch rep saying, deal with me. The client winds up in the middle. They get unhappy and call or write to Fidelity.

Another big difference, which again you would expect, is the average variable annuity that we sell is \$35,000. The average through the branches and frankly on the newer statistics is over \$40,000. It's \$39,000 through the investor centers face to face, \$26,000 on the phone. That subsequent payment number is the average size of a subsequent payment other than electronic funds transfer. So, there is a dramatic increase in the amount of dollars that you receive face to face as compared to on the phone. There's a statistic that I do not know, that I have asked that our people look at. I would like to know what the impact on additional payments is, as compared to which way the product was sold. Do we get more in the beginning through the branches and less as subsequent payments and vice versa on the phones?

When you get involved in service or even selling on the phones at Fidelity, you get into a whole different vocabulary. You deal with things called service level, average speed of answer, which is how quick you answer the telephone, and something called an abandon rate. These are things I never grew up with in the traditional business, and we are managed to exactly the same standards that the Fidelity is, which is 15 seconds on a call. But, the percentage abandon that we try to monitor is below 3%. In fact this client is calling to say he or she wants to discuss one of our products, we want to be able to answer that telephone. It gets kind of wacky sometimes trying to staff the major ups and downs. But, we monitor it fairly well.

I've now reviewed buying on the phones. I've gone through buying in the branches, which is primarily seminar-oriented. I'm now talking about once an individual has purchased and is now involved in service. Seventy-three percent of the phone calls we get are for unit values, contract values, so on, and we get, on the average, 1.5 calls per month per account. My variable annuity experience goes all the way back to 1969 in the Metropolitan, and I don't think any of us ever realized then, I'm not even sure at the beginning of Monarch, that the major difference between a variable and the traditional product is that these clients call. That can be a major pricing factor that I will tell you, in the early years may not have been thought of. It's something that is now a critical mass item. It's nice that your assets build. It's nice that you

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have more policies. But, the more policies you have, the more phone calls you get, and the more staff or automation you need.

Automation is absolutely critical. Again, dealing within the Fidelity is great because it is on the leading edge of much of this technology. For every voice response call it's approximately \$0.60. To talk to a live rep it's \$7.50. That is a major difference. You want clients on a machine for basic information. In fact, the next thing that we are looking at is the ability to transfer funds on a voice response up to 24 hours a day versus right now it's all done over the phone. The other standard that I have problems keeping up with, Fidelity is a 24 hour a day, seven day a week company. We aren't. For service we're open from 8:00 in the morning until 5:00 in the afternoon, and clients call you on Monday and express concern that you weren't open for the weekend. We are held to a different standard, and there's both good and bad to that. But, we get about 1,800 calls a month.

I wanted to show how things have changed, and I would be very surprised if many of the portfolios that you have, if you're involved in nontraditional business, are a whole lot different. We have variable annuities, single premium variable life, the single premium deferred fixed annuities, immediate annuities and insurance, which I guess for just about everybody else at this session would be the top item. As I mentioned before, our strategy now is just to that phase that we're beginning to cross-sell. We have no intention of trying to do every one of these products ourselves. If it's equity based we would like to manage the funds, but if it's beyond that, we've established strategic partnerships with, I'm sure, many of the people within this room for fixed immediate annuities or fixed deferred annuities or even insurance. With only 100 people to underwrite, develop systems, issue a case plus everything else, I think we would go broke before we got our first policy out. So, strategic partnerships between Fidelity and other quality carriers is exactly what we need.

But, we were about split in 1988 between variable life and variable annuities, and now we're nearly all variable annuities. Now, I have been here before. When I was at Monarch and 100% of our premium was single premium variable life, I became anxious with very good reason. It is absolutely critical for us to increase those numbers beyond where they are because we all know what the potential concerns of being a one product company are. But, again, in the Fidelity scheme of things where they're managing the assets, there's kind of a joke that I tell about the insurance business within the firm that says, if I was to do \$100,000 of annual premium and I was to go to some of the people that I work for, they'd say that's great, who manages the assets? It has nothing to do with the fact you make 70% on one contract and maybe 30% on the other. So, it's a different mind-set when you work for a mutual fund company.

I found something that was surprising when I put together this statistic. If you look at 45-65, there's only a 2% difference between the number of policies and total assets within that category. It was a whole lot flatter than I would have thought. I'm not exactly sure why. I expected more of a bell in the middle, and it absolutely wasn't there with 65% male, 35% female, which is interesting. When I was at Monarch our number was 52% male, 48% female. So, for whatever the reason is, it's probably the Fidelity client base. There's less a percentage of females purchasing this policy than males.

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Subsequent payments are the annuity within the annuity. What I did in the first calculation was to take gross sales during the years, in 1989-92, and the percentage of those gross sales that were payments after the initial payment, and the result ranges between 23-29%. Right now this year it's actually about 28% or 29% again. Then, I took assets at the end of the year and how much subsequent payments were made during that year. We had such a spurt in growth in 1992 that the 23% was obviously much higher than the other two. But, these preliminary numbers show that subsequent payments are more dependent upon sale volume, at least according to this, than they are upon asset base. But, again, these are very rough statistics.

Anybody who has had the opportunity to try to start a company approved in New York, which we did last year, and then get a variable product approved and a company approved in California, knows that that's an interesting experience. We just received company approval for California in December 1992, got policy approval, I guess in February 1993, and now California decides that it has to look at our application. So, I figure by October 1993 we'll be in business. But, we still sell a product in California, which is a Pacific Fidelity product called Income Plus. Pacific Fidelity's product has been with Fidelity Funds since the early 1980s, has no front-end load, no back-end load, as compared to our product that has no front end, but has a five, four, three, two, one surrender charge, which is still very competitive. There is an 80 basis point M & E (mortality and expense) on the Pacific Fidelity Life product and 100 basis point for ours.

When you look at that, obviously the no-load product is somewhat easy come, easy go. However, the next one is actually more interesting. You overlay this on mutual fund accounts, you can't even see the difference. Our experience with mutual fund accounts runoff is identical to a zero-front, zero-back annuity.

Fidelity is a very different company. The branches are discount brokerage, low cost, and the compensation is not what I grew up with in Merrill Lynch where the average broker made about \$200,000. It's very different, very efficient, fully loaded, all in, and its marketing and sales cost is 311 basis points on all products. The cost to go through the investor center is 225 basis points. That is not including the marketing, and it is not including the regional consultant. The regional consultant does three things: *train the reps, run the seminars, and deal face to face with the client.* Every one of these guys came out of the traditional insurance business where they were involved in estate planning or financial planning or something for the better part of ten years or so.

When I recruit people I will say that Fidelity is different, and it is different and it's been a tremendous opportunity. But, it's really interesting that it has had the opportunity to take the client base, which Magellan and all the other funds that came along helped to grow, take clients who are used to good service, are hand held and have the opportunity to cross-sell. What you really need in our case, though, is good service, first and foremost and second, a competitive product and the low cost of distribution allows us to be able to offer that product.

I don't know that it's unique. It's nice to be in my position, though. It's kind of hard to come here, on the other hand, in what is a very traditional environment because I want to get up here and give you something that you would learn from. I hope I

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have succeeded, on the other hand I say it's kind of unique in being so out of the traditional business that it's interesting but nice. In fact, to close I guess I would say I've been at Fidelity for four years, and you absolutely know you are out of the mainstream when not one headhunter has called you in four years.

MR. MARRA: I have a question for Rich. I was interested that 66% of your annuity sales are coming from the investment centers. How does that contrast to the mutual fund sales, roughly, I assume it's higher?

MR. JAMEISON: I don't know what the statistic is. I can tell you as a percentage of mutual fund what we write though, it's about 6%, and I think you've all found this in the business that you're in. As funds go, variable products go. There's a correct correlation. But, there's a tremendous amount, in fact, the dominance in funds are still done via the phone, absolutely via the phones.

MR. MARRA: Do you think your phone volume will continue to rise in the relative proportion of annuity sales; the 33% that's coming through the phone activity?

MR. JAMEISON: It's really interesting. I think that we are not getting as much on the phones as we could. If you categorize prospects in three parts, those that are really interested, those that might be interested, and those that aren't interested at all, with only 22 people on the phones and 400 and some odd people calling every single day, I think we do a very good job at closing the people who are easy to close. I don't think we have enough time to go out and do that to second levels. So, I think we're probably losing something there. On the other hand, as soon as I went out and hired ten people, the market would probably fall, and then you have another problem. So, it's very difficult to manage what that right number is. I just don't see, though, how the numbers could get much bigger than that \$10 million that they're writing already. You just take the average length of a phone call times the number of phone calls and the day is gone. So, I think we will expand.

MR. NOVIAN E. JUNUS: I noticed that you had 3% of sales for immediate annuities.

MR. JAMEISON: That's a cost, is what that 3% was.

MR. JUNUS: You had 94% sales for variable annuities and then you had 7% or something and 3% for immediate annuities. Do you actively market that, or do people call up for that?

MR. JAMEISON: I would say that most of those sales were done face to face. Again, this has been very interesting because I think back, I'm not sure I ever knew anybody when I was in the traditional business who ever wrote an immediate annuity. But, I'm sure there were some. But, when I first went to Fidelity and you look at a million people who are in retirement accounts and you know they're eventually going to come out, we are beginning to actively market that. We would look at people who are taking dividends that are over 65 years old. The hard part is to overcome the fact that they don't get any money back. Systematic withdrawal is also very big in Fidelity. We've only begun. You can only do so many things at a time. We're really now at the point where we have hired a product manager, and had a major focus on that. We're also in the process of developing a variable

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immediate annuity that is filed that we believe may be a good alternative product because the Fidelity buyer can still keep it in funds, but yet the payoff varies directly in relation to the fund performance, which is a different kind of a product. Our goal is to split it. In other words, some fixed, some variable. But, it is the next market for us, we believe.

MR. MARRA: A key issue we heard at this meeting is the impact of lower interest rates and the strain that's putting on company expenses. In the example of Rich's company and mine it's moved a lot of the business towards variable where you can still get the spreads. How do you see the market's ability to come to grips with the high compensation costs that our industry has built itself on, in light of declining interest margins?

MR. SHUMRAK: Well, I think that certainly with the market doing well combined with the low interest rates that's fueled the sales gross. But, I think that, when the market drops back down at some point, I don't think we'll see so much of a shift back to the good old days. I think that in a lot of markets what you can get out of a fixed annuity you can get out of a variable if you direct everything into the fixed account. Again, there are other considerations both from a company point and a customer point of view. But, I think things are going in that direction and then when you overlay on that capital management issues, it makes it even tougher.

MR. MARRA: I happen to agree with that. I think the shift that's gone to variable business is not a function of market conditions with just lower interest rates. This is a permanent shift, in my opinion.

