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JOINT VENTURES/PRIVATE LABELING

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Many companies, rather than developing products from scratch, are joint venturing with companies offering life and annuity products. A panel of experts of companies doing ventures will respond to questions.

MR. TIMOTHY F. HARRIS: We have three experts in this area. Rodney Brown is a vice president of new ventures with General American Life Insurance Company, and prior to that he was an actuary specializing in product development. Bob Glassner is marketing vice president for reinsurance at Business Men's Assurance (BMA). He has worked in that area for 25 years. Bob heads up an operation in this area that includes an actuary plus supporting staff. Andrew Galenda also works in this area and is also an actuary.

I'd like to know how many of you are familiar with the concept of joint ventures and private labeling. Could you raise your hands? So, the response is less than half. How many of you are here to learn what it is? Very few are. How many are presently doing it? How many of you are presently involved in some type of joint venture/private labeling deal? It looks like maybe 10–20%. So, that's really a sizable number of people. That's interesting. Well, we're going to start off with Rodney who's going to lay some of the groundwork for the joint ventures and private labeling area by defining some terms.

MR. RODNEY R. BROWN: The title for this session is Joint Ventures/Private Labeling, but we'd like to expand that to a definition that simply encompasses any kind of relationship that's being formed out there between parties within the financial services and the insurance industry. In relationships that are looking for synergy through the trade-off of benefits and cost, you'll find some ventures that are very formal, including legal documents. You'll find others that are very informal; "We'll just work together on this deal." So, there's quite a blend going on out there, and that's what we want to talk about.

MR. ROBERT H. GLASSNER: I'm really pleased to be here. The definitions I thought we would throw out happen to be the definitions that we kind of agreed upon, one of which would be the term *turnkey*. I'll define turnkey, in this example, simply as you are the customer and we are the provider. Turnkey would be our product on your paper. We do the administration; we do the underwriting; we do every part of the process of getting that policy to the consumer.

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Private labeling and/or true turnkey then is when we manufacture the product, underwrite, administer and get the product to the consumer; but it is still on your paper.

Another term that is being bantered around is corporate agency marketing, which typically is our product on our paper; but it is tied in with your distribution. I might add that one of the meetings that is growing quite rapidly in our industry is the Inter-Company Marketing Group, which started about eight or nine years ago. It meets in Phoenix in January 1995, and it is almost like an auction house. The people who go to the meeting typically tell what product they would like to put into the arena or into private labeling and sharing a product. They are also looking to see if there's something else that they might take back with them that's being offered in the marketplace.

MR. BROWN: What would you define as private labeling?

MR. ANDREW S. GALENDA: I would define private labeling as having the manufacturing company really doing the product development, the actuarial functions, the underwriting functions, all of the back-office functions, the claim administration, which for group disability is an important aspect of the product, and having the client company be the distributor of the product. Also in private labeling I would envision the manufacturing company taking on a decent portion of the risk, generally.

MR. BROWN: Does anybody have any definitions that he or she would like to share with us? Does anyone have a type of partnership or venture he or she thinks we ought to discuss at some time during the day?

FROM THE FLOOR: Could you discuss for just a second the characteristics of the company that might be the customer in this joint venture relationship?

MR. BROWN: That's a great lead in to where we're at in terms of what's going on and why it is happening out there. Also, what are some of the reasons for creating these kind of ventures? The characteristics of the companies are important. A company that feels that ratings are important is a candidate for these ventures. Ratings have come into vogue over the last few years. The insurance industry didn't worry about them before. Now we find there are 150 companies out there that have at least a Standard & Poor's, a Moody's, or a Duff & Phelp's rating. That means there are a lot of companies that don't have any ratings. There are a number of companies that have a rating that perhaps is not as strong as they'd like. You'll find that, when rating is an issue, a company may be able to mitigate that problem if it finds a partner that can bring either its paper or its backup to the first company. There are some relationships being built to address specifically rating issues.

MR. GLASSNER: Another buzzword for that ratings problem is *credit enhancement*. It's kind of a nice term, which basically is combining our Best's rating with yours, because you have distribution and we have the ratings and the capital. This leads to the second reason, capital and surplus needs, which can be defined in many different ways. It seems to me that the message most people bring back after visiting Best's is that Best's wants us to grow our capital and our business at the same time. That's not easy to do, particularly in some of the products that we deal in.

Therefore, you look for a partner that might be able to bring capital to your distribution. We are seeing more of these relationships in the annuity market, and it appears to us that it is basically the borrowing of capital. It's awfully hard for any of us at our companies to turn off distribution and turn it back on. Then you also find sophisticated distribution forces that are now coming to us wanting some form of guarantee that they won't be shut off once they get production started.

MR. HARRIS: Aren't you then basically turning insurance companies into agency operations? What's in this for the insurance company? You're replacing some of the profits on their products. Aren't you keeping a portion of the profits on these products?

MR. GLASSNER: I don't know of anybody that does anything like this for no profit or just does it to be a nice person. In sales, it's a matter of a need and a company that can fill that need; but it's not any different than reinsurance in its basic sense. Any time you reinsure a product because of restriction of a retention, you're going to also share future profits in that block. If it's coinsurance and/or YRT, you're obviously going to dilute your profit. It goes back to strength and the ability to do it. I don't think anyone wants to get into this environment, but if you do wind up with a less than A+ company, it's an option to consider. Let's just focus on A- companies. There are a lot of quality A- or B+ companies out there that, unfortunately, cannot grow in this marketplace; and they're looking for these kinds of relationships to survive.

MR. HARRIS: What type of products are you talking about offering that require higher ratings? Are these annuities? Corporate-owned life insurance (COLI)? Exactly what is it that companies like your companies are offering in this area?

MR. BROWN: There are a couple of areas from the standpoint of, the rating question rather than just providing capital. One will be small-to-mid-size companies that simply do not have the rating or have the A– rating that Bob was talking about. The particular markets they have traditionally been in may now be served by competitors with stronger ratings. These competitors are trying to meet the competition. Another area is the large case corporate purchase or sponsored market. There the distribution demands the highest rating, or the insurer does not get to bid. An AAA company will work with an AA or a single-A company and create a relationship where one will stand in for the other, in order to provide the best rating strength.

MR. GALENDA: I would also think the rating becomes more important where you have longer-tail liabilities. I think another issue on capital and surplus, too, is that companies want to invest in lines where they're going to do well, where they're going to get a good return. There may be companies that are shedding a line of business because they can't achieve a proper return on the line on their own, but they may not want to shed the product. They may still want to have the option to offer that product.

MR. BROWN: That's an interesting point. I read a study recently where the researchers took 50 or 100 companies in a category size. The ones that are running more efficiently are on the right-hand side of the scale versus the ones that are running more expensive operations on the left side of the scale. The ones on the right side typically aren't in as many lines of business. They're more focused on certain products and do a very good job. These efficient companies are not looking to be diluted with a lot of other products, particularly products that have a lot of cost. These companies may consider providing their distribution with a product but not spending the effort to do it themselves. Offering another company's product is not a bad way to find out if you can distribute it before you make any major capital investment.

We have been taking a few moments to give reasons why we see joint ventures being formed. Typically we don't think of looking outside our own office. We typically don't think about looking at our competitors. We typically don't think about looking even outside the life insurance industry when we have some problems. A message we want to get across is that there are some alternatives out there that haven't been looked at in the past. Bob mentioned distribution. That's another great reason to consider some kind of relationship with another group. There are a lot of companies out there that just aren't growing, given their traditional distribution. They have some good products. They have some good distribution. But they are just not getting the growth they need. One of the things they can look at is to find somebody else to help distribute products. Find third-party marketers. Find other distributors. Find other companies that are in that market, that would like to use your product.

If you're looking at distribution from a standpoint of just trying to capture some market share, the thing to look at is, who's starting to peck at the fringes on that market? Sometimes it's better to join them than to fight them. These relationships give you an opportunity to look at some alternatives that otherwise you'd never look at. Maybe it's direct marketing. Maybe it's an affinity group or bank distribution, or late-night-TV advertising. How do you try that and still not place yourself in the face of your current distribution? Find a company out there that's already using that method. Get some expertise from the people there and give it a go. It's a good way to get yourself out there on the fringe without a big commitment and without antagonizing your current distribution system.

MR. GALENDA: There are some situations in the group marketplace where there are companies that have a sizable presence in the large case market that don't really have a strong presence in the small case market. They may enter into an arrangement with a small group carrier to distribute their product. So, it gives carriers an opportunity to get into markets that they haven't been in. You may also have situations where you have a specialty or a niche carrier. Let's say for example, you had a carrier that was very active in group medical. It may be selling medical to employers that are buying a group disability product from another carrier that also offers medical. As a defensive move, the medical carrier may want to offer a disability product.

MR. HARRIS: It sounds like these joint venture operations can offer to an actuary a solution to some of the problems that he or she has with the marketing department where the marketing department people are always complaining that they don't have this product or that product. It sounds like an actuary could put together a portfolio of many products that would cover virtually any type of need without going to a tremendous amount of effort. Is that correct?

MR. GLASSNER: It's absolutely correct. As the market begins to move down the road, it's going to get even better. You can have those products on your paper, and in most cases, you will be asked to participate in the risk. But, in fact, one of the other examples is past experience, which will keep certain CEOs from ever getting involved in a product.

I've jumped but disability income is a perfect example. I can verify that there are a lot of companies out there that, for whatever reason, have had bad experiences. They don't feel they understand the market. They've heard rumors that it's a dangerous market. They will not get involved in disability, but they do have needs to distribute it; and it's being distributed by their agency force anyway. Through this kind of relationship, the provider can bring that product to the company. It can either be on the first company's paper, or it can be on the provider's paper. For all practical purposes, the company is distributing it. The company needs to keep some risk if the product is on the company's paper. If disability is managed correctly by the provider who has the experience and the expertise, the company might gain a little confidence in that market and, ultimately, keep some of the risk. So just to come back to that, Tim, yes, you're right.

Another misnomer that I think I should correct real quickly is it's not just the professional reinsurers that are doing this. In fact, if we drew up a list of reinsurers and nonprofessional reinsurers that are providing these kinds of turnkey situations, there are as many nonprofessional reinsurers doing it, if not more than there are reinsurers doing it in particular products like last-to-die, disability income, and so on.

MR. GALENDA: These arrangements allow you to get a product to market quickly and with less start-up cost. Some products will require extensive systems investment. On the disability front, for example, it is expensive to put together a disability claim system. Even if a company has a long-term-disability claim system, it may be quite an investment to develop an integrated short- and long-term-disability claim system. Private labeling is one approach to limit those investments.

MR. BROWN: We're talking about unbundling the functionality of the life insurance industry. You can start with the product development, the product filings, the marketing, the distribution, the pricing, the administration, the underwriting, the investment management. All those functions can be performed by somebody out there other than yourself, and you'll find a smorgasbord out there.

MR. GLASSNER: I think there's another point that needs to be made, too. I don't think it has to be black-and-white. For example, whether I do all the administration underwriting or you do all the administration underwriting on a particular product, I think there's room for something in the middle. One of the problems of doing a true turnkey situation, where we bring all the process into our store but deliver the product through your distribution on your paper, is that your cost doesn't really go down. You still have to maintain an underwriting staff for your other portfolio, and you've diluted that by not giving the staff additional business to underwrite. You still have an administration system, and most of the people I've talked to want more business on their systems, not less. So I personally feel that the blend is much better. If there are certain things, such as with a variable universal life (VUL) product, that you just can't do, that's one side. But if, in fact, we were talking about disability income, there's no reason why we can't educate and help you get your system in line to handle and manage the product. Likewise, we would be able to do the disability income from an underwriting issue and policy service basis, and we then become a reinsurer. Again, when I say reinsurer, I'm not talking just about professional life insurers. Even though they do ultimately come up with a reinsurance agreement, they are not a professional reinsurer. So, just to reiterate, keep as much of this in-house as you possibly can, and fill up your own systems. I think the blend is good.

MR. GALENDA: And I think it's important for a distributor to deal with a manufacturing company that's going to work with you to identify your core strengths, your core competencies, and your needs; it must be someone who can be flexible and work with you to help best achieve your needs.

MR. HARRIS: Before you move on to specific examples, maybe we should stop and take questions from the audience regarding definitions. Does anyone have any questions?

MR. ROBERT A. GABRIEL: I need a clarification from Rod Brown. You mentioned how you could have a formal arrangement or an informal arrangement. It seems like you could get into a lot of legal problems with an informal arrangement. Can you describe what kind of situations you might do informally?

MR. BROWN: What I was referring to as informal can be explained by an example. One company may offer administrative service and another company offers reinsurance to the same market. The two companies may decide to jointly market their services. The buyer gets the joint pitch but has to purchase services directly from each company. The two companies approach the market jointly but each has to deliver on its own.

MR. GLASSNER: Formal to me is when you get involved with annuity reinsurance. This type of arrangement is very complex. In fact, the Society had a presentation made a year ago that covered the problems in these arrangements, i.e., what happens if the interest rates change? On the other side, we develop a term product, and we take that term product to the market and support the company by using our mortality experience and taking the majority of the risk. This would be an example of the informal. It's not very difficult. It's a basic reinsurance agreement. These can be very complex, or they can be very simple. Certainly I don't think we would suggest that there not be an agreement signed.

MR. BROWN: I think another point is the actual structure the agreement may take. It may be an agreement, a true joint venture, or a very strong legal corporate entity. It depends on the nature of the enterprise and issues of control.

MR. GLASSNER: We'll discuss it further when assets get involved and who gets to look at those assets. You also get involved in trust agreements. They're starting to become very common now in these types of agreements because everybody looks at the assets and watches how they change every day because that is part of the risk. If one company winds up with more risk than it expected, it certainly wants to know what the assets look like, and so that complicates the trust concept tied in with the contract. The unfortunate thing about that, though, is if it gets stretched out too long and you try to dot too many i's or cross too many t's, you lose the opportunity, and that's something that has really hurt this industry over the last 10 or 15 years. We, as a group of people managing these companies, have tried so hard not to make mistakes. Sometimes the opportunity goes right by us, and that's another balancing act that you have to do. You must pick the right partner to sit down with in the first place.

FROM THE FLOOR: One of the interesting dimensions of joint venturing you might be interested in was the fact that there's an international aspect to it. About 18 months ago my company in Australia was approached by a specialty U.S. insurer to joint venture a particular line that we're having a bit of difficulty with. That hasn't progressed too far, but that specialty insurer is currently talking with our British subsidiary, and I think that some progress could be made there. Not only do, obviously, U.S. companies have particular areas of expertise that they could use internationally, but there are overseas companies in Australia and the U.K. that I think could offer expertise to U.S. companies in a joint venturing arrangement. You must not think only domestically; think internationally as well.

MR. GLASSNER: That's a good point. We promised we wouldn't mention any companies and do any advertising. Approximately five years ago, a British company introduced the dread-disease policy and brought it here to the U.S., choosing one or two companies to initially show the statistics, the mortality, or whatever tables the company used to price the product.

MR. GALENDA: Some companies have made inroads into the Canadian market that way.

MR. HARRIS: Do we have any more questions before we proceed to the next topic?

MR. BARRY JACOBSON: I just would like you to talk about this from the agent's perspective. In what situations would you see agents as being better off going through their primary carrier rather than going directly to the company that originally produced a product? I would imagine they'd be able to make more money going directly to the first carrier.

MR. BROWN: Certainly that's an issue if you're going to pair up with somebody to further penetrate a market you're already in. You have agents already participating in that market. You may be trying to fill a void for your agents with a particular product. Companies have requirements in terms of production levels, conference credits, health benefits, deferred company programs, and so forth that can only be met by placing the product through the company.

MR. GLASSNER: I have one other comment. Remember, the trend is that the product will be on your paper. I'm not suggesting that the agent won't find out at a convention that a product is being supported by another company, but the trend is definitely other companies' products on your paper. For example, term conversions won't cause a problem. I'm not saying that is totally disguised, but I don't know that it makes any difference if the agent knows or doesn't know.

MR. ROBERT COMEAU: In answer to this gentleman's question, another reason why the agents would like to keep with their primary carrier is that they make their money selling products and working with their clients. The time that they would spend researching the market on what is a good disability product or another type of product takes time out of earning money, and I've had agents tell me, "Why doesn't your company or our company just go find some of these best products out there, make them available to us," and, yes, you guys will take a little bit off to help marketing and managing that for us in the distribution process, but then we don't have to worry about researching the market. We know that you'll take care of us from that standpoint, and then we can sell the products that you actually manufacture.

MR. BROWN: That's an excellent point.

MR. JEROME S. COMM: Just another point of definition. Maybe it doesn't come under the topics under discussion, but what about a managing general underwriter that might have a marketing force selling a particular line of business that puts together a pool of companies to underwrite the risk and some of which use their name and their paper to issue the coverages? Would that come under the range of what is up for discussion? Because there are situations I know of similar to that.

MR. GLASSNER: I don't know that it does. In fact, I don't think we've discussed that in our planning for this discussion group. We refer to those as line slips with multiple company involvement. The only problem with line slips is they are very difficult. The more companies involved, the more difficult it becomes for all parties to understand what they are getting involved in. This sometimes leads to litigation, and that's the last thing any of us want to get involved in. The one-on-one works a lot better and smoother, and there's less room for misunderstanding. A line slip member, if claims go poorly, starts complaining, saying I didn't know we were getting involved in that particular block, and I didn't know this, and I didn't know that. And all of a sudden, you're in arbitration. It's just ugly, but, yes, that is going on. I just don't see that to be a trend.

MR. COMM: There's one particular situation that I know of that has been successful, but you're right. You need very tightly drafted contracts, and everybody has to be fully informed as to what they're getting into.

MR. GLASSNER: Our next section is to cover actual joint ventures that are in place. Rodney and I share the first topic, and that is the term insurance marketplace. The term marketplace to me is really intriguing because it's awfully hard to justify or to explain what's going on. A lot of it has to do with market share. Most partnerships consist of sharing of risk, even though there are some ceding companies that request no participation at all. For example, in New York, the regulator would never allow zero retention. Reinsurers and nonprofessional reinsurers have been designing term products for other companies for a number of years. The design includes the reinsurer's mortality experience and underwriting expertise to make the mortality hit the mark that is needed to get the price to where it is. The company that actually has the paper is keeping a very small risk or percentage of that risk. Now, that's not new. That's at least 15 years old. And the amount of business that's being done that way is growing in volume.

You also have the other side of some of the more competitive term writers that have not been in the reinsurance business. They have saturated their distribution, and now they're taking their product to market saying, "Let us teach you how, because who knows better than we do because we've been writing term insurance exclusively for almost 55 years?" So, that's an example right now in the term product marketplace. Many companies, particularly mutuals, don't want to get heavily involved. They want to protect the dividends of their core business, which probably is a dividend-driven product, and they just want to lay that mortality risk off. Another twist on that, though, is at the time of conversion, you can have it back. That's kind of an unusual twist, but that's not that new. Giving up the conversion only amounts to about 3.5–4% of the business, so it's not a real big issues.

FROM THE FLOOR: How do you get it back?

MR. GLASSNER: You can fill your retention at the time of conversion.

FROM THE FLOOR: Even if it's on private label?

MR. GLASSNER: Yes, it's on your paper. It's not on my paper.

MR. HARRIS: Doesn't this concept continue to drive the term insurance wars? Aren't you then making the term insurance more competitive? Would those companies that don't participate in these types of arrangements be at a competitive disadvantage?

MR. GLASSNER: Absolutely, and I don't think it's necessarily fair. Again, I would only suggest this. There are some companies that offer that same service to any size company. You don't have to be a $5 billion asset company to get that kind of deal. It's available. You have to ask for it some time. Quite frankly, the nonprofessional side that wants to take its term portfolio and tie it into some other company's paper and distribution won't have very good luck going upstream (meaning companies larger than it). So, you see that trend coming down for the mid-size or smaller companies. And is it fairer than it used to be? Does it still drive what the price will be for term? I can't stop that. I'd love to. I got in this business when all reinsurers had the same rate.

MR. GREGORY L. FITZMAURICE: How do you go about finding these partners? I mean you can't just pick up the *Directory* and start calling around. The reinsurers I've talked to don't seem to be that interested in joint ventures. So, how do you find these partners?

MR. BROWN: There are some entities out there that are in the marketplace just to create partnerships. For lack of a better term, they're consultants. They either come out of small actuarial firms, out of small benefits firms, or they simply leave companies and start things up on their own. Their job is to act as intermediaries and try to put together some partnerships. They expect to be compensated by a fee or participation in the venture. I would suggest that what you look for is groups like ourselves to become better at marketing what we do. It's relatively new in terms of marketing joint ventures to partnerships.

MR. GLASSNER: If you look to the reinsurance marketplace that also has a direct operation, you'll find higher activity than a reinsurer that has no direct operation, but I don't think that's always true. As I mentioned earlier, Inter-Company Marketing Group is an organization that meets regularly, has membership dues, and so on. It has become the gathering point for both sides: people who are looking to participate and not bring anything to the market and companies that are coming to either bring in or bring back an idea on a joint venture. But the vast majority of your professional reinsurers are doing something in this area, and much of it has to do with the level of expertise they have. Disability income is something that BMA does because we have so much expertise in that area. So, it was a natural for us to get involved with joint partnerships on disability income.

MR. HARRIS: But it seems that there are different companies that specialize in different products and possibly different companies that specialize in different sizes of partners. Let's say you're with a small company, and you're looking for a package of products. How do you find these people?

MR. GLASSNER: Ask your reinsurance representative or give me a call. Both Rodney and I agreed not to advise, but we know the participants.

MR. HARRIS: Who's offering a second-to-die product, for example?

MR. GLASSNER: Indianapolis Life has been doing it now for about four-to-five years. It will actually provide a last-to-die product, and I'm told it's a very good one. BMA, on the other hand, doesn't have a competitive last-to-die product. We don't feel we can get enough critical mass on that product. Therefore, we've chosen not to be a big player. So if you're looking for a last-to-die product, Indianapolis Life is a resource.

MR. GALENDA: And I think it's the case that a lot of the activity is really happening on the individual side of the business. I think there are only a handful of companies that I'm aware of that are involved in the group side of the business. I'm not sure exactly why that is the case. Does anyone have any insights on that?

MR. GLASSNER: When you talk about group you have to define medical and nonmedical.

MR. GALENDA: Group disability.

MR. GLASSNER: There's more activity on the nonmedical than there is on the medical side for lots of reasons. There are companies that want to diversify their distribution on group disability, group AD&D, or group life. I don't know of any company out there that's willing to provide a health portfolio for this distribution.

MR. TIMOTHY J. TONGSON: I'm just wondering, when you have partners in a joint venture, and they're bringing different things to the table, maybe something intangible like the distribution force, how do different companies determine how to share in the value that's created by the joint venture?

MR. BROWN: There are a couple ways to look at it. One is, if a company needs some support and has some gaps to be filled in, you typically handle that with a third-party arrangement. The company buys that service, and there's not any real venturing. On the other hand, if you're trying to put together something from the ground up, for example a VUL product, you want experienced partners. Perhaps you are already in variable annuities and want to get into VUL. You want a partner to develop the life insurance side of it that can help you on the administration side. Who can help you on the mortality risk side? There are companies that can step forward and fill in these spots. How are we going to share in valuing this? There are different arrangements. You can build your cost into the product and take profit from the way you would have cost exposure. You cut it up in sections and get a return back from each of those. You can look at it in total and try to pool in some way. Create a pooling mechanism so that all share on the overall outcome of the venture. A dividend methodology is applied based on the level of capital and risk participation.

MR. GLASSNER: Another facet is that besides the reinsurance agreement, the provider also shares in the expenses. Therefore, if the reinsurer is accepting 80–90% of the mortality risk, it also accepts the same ratio on the expenses. The writing company must follow the guidelines set forth by the reinsuring company.

MR. CARY O. LAKENBACH: I have a couple of examples of how to get interested parties together, which is one of the things that we do. In particular, in one example, we have an insurance company relationship where the insurance company is not interested in participating in a mortality spread situation. It has been in variable annuities almost exclusively. It has heretofore farmed out any mortality risk that it has had. The company wants to get into VUL situations. It feels that it has the distribution outlet to be successful. On the other hand, there is Insurance Company 2 that wants to be a low-cost manufacturer and does not want to worry about procuring distribution. We have relationships with each of them. We brought them together. They are working together to develop a product. In the second example, there is an insurance company that has started its own TPA. One of the comments in this meeting was that it was getting estimates from its own internal operation, and it decided to go outside. The company went outside, and not too soon after going outside, its internal operations started reducing its time estimates in half. There are very good insurance company operations that have, in effect, spun off their own TPA, and they want that to be a profit center. We have a situation in which a marketing and actuarial consortium, that includes our firm, has brought a product idea to the insurance company operation. The product will be developed, and it will be marketed on a private label basis to the outside, and in that specific instance we will have a participation agreement, if you will, participating in the risk. That enables the insurance company to keep its costs down and we hope to be successful.

MR. HARRIS: Those are excellent examples.

MR. COMM: I have a question that we've run into in similar situations having to do with perhaps one company that is using its name on the paper and reinsuring as part of this partnership arrangement or whatever you might call it to a smaller company or one that isn't as widely licensed. Is any consideration given to cross-licensing—making sure there are no conflicts in the licensing of one company as compared to the assuming carrier so that the ceding company gets its proper credit for reserves on business ceded? We've run into that problem in certain states.

MR. HARRIS: It's not a question of state of issue. It's a state of domicile case, except I think there may be some state of filing issues as well, but the smaller company here would not be filing in states in which it was not licensed. The smaller company also would not be writing insurance on its paper in states in which it was not licensed. This would be on the other company's paper.

MR. COMM: The situation I was referring to is a situation where a company had the marketing capability, had distribution capability, but didn't have the capital or surplus required to allow the market its full capability. So, the company sought to enter into arrangements with other companies that had sufficient capital and surplus but was not a widely licensed company, and there are certain states, I believe, that didn't allow ceding business written on policyholders in that state to another company even though that other company had sufficient capital and surplus but was not licensed. So, in other words, these states did not allow ceding to an unlicensed company unless there was either a letter of credit or perhaps a custodial or trust account. I'm just wondering if this were done regularly and just how this was handled because I'm told that, if the ceding company is large enough, in many cases it doesn't worry about these types of problems depending on the size and the relative scope of magnitude of the amount of reserve that's ceded off.

MR. GLASSNER: I think the company ought to worry about it. I don't think you can do that.

MR. COMM: I don't either, but it seems as though it is going on where there isn't a concern where the amount of reserve ceded is small.

MR. JOSEPH PAESANI: The joint venture project we're working on is actually with a sister company, with a different distribution system and a different product line, and what we would like to do is try some of the sister company's products in our distribution method. We would have to develop the product, develop the administration. We would have to start from scratch to bring in some of the sister company's product. So, we're trying to put together an arrangement where we bring the sister company's product. Ideally, that company would keep most, if not all, the risk. It would do the administration. We'd provide the distribution. In theory it sounds like it should work easier with a sister company because everyone is under the same umbrella. We do struggle through this.

When I was a kid it was always easier to make a deal with my friend than my brother. I don't know how that goes. But some of the things we've run into here are, first, a competitive issue. The sister company is worried that we will be in competition with them. Second, as another gentleman mentioned, is the compensation issue. Once you agree on the mechanics, what changes hands between the parties? And one problem we found is, when you try to break up the pieces, that doesn't necessarily mean all of the expenses are going to go with them. I guess the third major issue we see in this situation is, since we're under the same parent, and we have our own sets of objectives to satisfy the parent, there's a built-in turf issue. It sounds like this type of arrangement falls in line with some of the terminology and some of the definitions you've laid out there, but I'd be interested in some of your comments with regard to coping with those three aspects and dealing with that.

MR. GLASSNER: If you put aside the arm's-length concept and don't break any IRS or SEC regulations, I think your comments are right. I think we might all agree that allocation of expenses inside a corporate structure is very difficult. It makes sense if you can come to an agreement on the expense issue and keep it in the family structure, but that can be difficult.

I will make one other comment about the distribution. I'm really tired of the competition thing between distribution and/or agency forces. We're in a marketplace that needs as much top-line revenue as possible, and I think we need to break down that paradigm that you might upset your agency force by starting a brokerage operation.

MR. GALENDA: I think that's a really good point because, if you have one arm of a company competing against another arm of the company, each arm has plenty of competition out there already. So, what's the harm of having another competitor? Let the market decide.

MR. GLASSNER: Typically, if you give the agency force the option to be a broker or agent, once they look at the commission and the resources provided, the agent should have no complaints with his or her status.

MR. BROWN: It sounds like what you described is what Bob penned a corporate agency. You sign up as a corporate agent of your sister company. All you want is to be able to offer those products. You don't want to build the back office to take care of it, and you didn't particularly want to take on the risk. Corporate agency seems the cleanest.

MR. HARRIS: It almost sounds like you need a facilitator or maybe a marriage counselor to iron these problems out.

MR. PAESANI: It's not really that bad. It's just that you have two philosophies at work there. And I think where we're trying to come down is, hey, let's just get close and try it, and see if it works, but if something does work and something does test well, then let's stop again and split things up.

MR. BROWN: When you get into joint venturing, you might want to consider bringing in a third party. Sometimes it makes a great deal of sense to bring in a third-party consultant or a third-party actuarial firm or somebody out there to play referee and help the marriage work. Tim's right-on. When you're trying to discover how to coordinate, make decisions about risk sharing, and how you are going to compensate each other, you can kill the deal before it ever gets going. If you have somebody else who can facilitate, keep you on track, and get your eyes set on the long-term goal, there's something to be said for taking that step.

MR. GALENDA: I think the marriage analogy is a good one. On the other end, you also have to consider the terms of divorce. Each party's going to have a great deal invested in what's happening, and I think it's beneficial to think through all aspects of the marriage.

MR. GLASSNER: Yes, these deals don't last forever. An exit to the agreement must be discussed up-front.

MR. ALLEN D. BOOTH: I do some consulting in this area, and I have a question regarding a regulatory aspect. I'll sort of cut through some of the complexity to make it more or less a hypothetical question. XYZ Life Insurance Company sells single-premium deferred annuities (SPDAs) through brokers and personal-producing general agents (PPGAs). Because of a relationship at the board of directors level, XYZ gets into conversations with the Seventh National Bank, and they decide to sell SPDAs through the bank, and the deal they're going to make is that the investment's going to be done by the bank's trust department, and the company's more or less going to credit an interest rate consistent with the bank's investment performance and/or allow the bank to set the crediting rate. What regulatory problems exist under this scenario?

MR. HARRIS: That type of product actually has been around for a number of years. That's called a wrap-around, isn't it? I've seen that done before. I don't know what the regulatory problems are with it presently, but I know a number of years ago there were no problems with it.

MR. GLASSNER: No.

MR. HARRIS: Is anybody aware of any regulatory issues? I'm not aware of any. Are there any banking regulations?

MR. BOOTH: Let me try this again. I sort of asked a loaded question. It's been brought to my attention or it has been claimed by someone with whom I have had a discussion that there is a problem at the state level in terms of the marketing compliance. If two customers in the same community end up with a different result from the same product coming out of the same company, I'm not exactly sure what regulation or statute this might be running afoul of, but I was hopeful that somebody here could enlighten me on this. Second, I have a suspicion or at least a concern that if I take a product to somebody else to administer, market, set rates, and so on, particularly with respect to SPDAs, that I may end up with an SEC problem.

MR. GLASSNER: We were not going to discuss annuity reinsurance because through research we found that this subject was handled quite well. From the *Record* of the October 25, 1992, SOA meeting held in Washington, D.C., may I refer you to Volume 18, #4-A, page 1727, titled "Asset Coinsurance."

MR. HARRIS: Well, regarding the SEC problem, I think on annuities there's a rule-of-thumb on changing your crediting rates. If you change them too frequently, then you're at risk for an SEC problem. If you change them, say, annually or semi-annually, you may not have a problem. Is that the issue that you're raising?

MR. BOOTH: Yes.

MR. HARRIS: OK. That still is an issue, I think.

MR. BOOTH: More directly, if it's the same product.

MR. HARRIS: Well, you have the same life insurance product with different premium rates that may vary by band. There are some companies that sell the same life insurance product with different premium rates that vary by commission rate. I've heard the issue before. I'm not sure what law people are concerned about when they raise the issue. I've heard it before, but I really don't have a total answer to your question.

MR. GLASSNER: Here's a copy of that program section for you.

MR. HARRIS: Why can't you change the name of the product, just modify the product slightly?

MR. BOOTH: I think there's an issue of an active regulator. I'm not necessarily talking small states that would do that. New York has concerns of that nature. I happen to be from Wisconsin.

MR. JAMES R. MAKIN: I wonder if you'd get into the same problem if you had, as has just been mentioned, different distribution systems. You're going to have perhaps different commission structures, and I wonder especially with an SPDA if you'd run into a similar thing. You could buy it from several different shops or several different outlets, and you'd end up with different results. This could be a real mess for some of us who are using or trying to use many different distribution systems.

MR. HARRIS: I think that concept might apply to some of the term products that we were talking about earlier. Something that the reinsurers are doing is taking what's called a customized product, but it's basically a shelf product, and modifying the premiums to fit that specific company's expenses and commission schedule. So, there you have premium rates for basically the same product that are going to vary by insurance company.

MR. GLASSNER: I think you'll find that in these arrangements, when we bring a product to you, that you get 90 points. But the difference in the commission usually is in the breakdown of that particular company's distribution. If you have a branch office system versus a pure general agency system, the commission might be a full 90 points going to a general agent (GA). On the other hand, in a branch office system that same 90 points might be divided among the agent, or the district manager, with points going for health insurance, 401(k)s, and so on. I think you'll find, if you dissect these, they're clean. The commission is the same for everybody, but when it finally gets to the street, it looks different because the distribution is different.

MR. BROWN: We hadn't planned on spending much time talking about the regulatory problems that could come with joint ventures. There are issues even when you're working within your own family of companies. States may regulate how much profit, dividend or expenses go back and forth between those companies. A point to make is that there are all kinds of excuses you can find not to do ventures. If you want to believe it's tough, you can believe it's tough. On the other hand, what we're suggesting is that there are plenty of people out there who are willing to talk to you. There are plenty of other companies and organizations that are looking to try to move ahead, trying to get out of the old way of doing business and find some new ways of doing it. You can discard those ideas real quick with the old, "Yes, but what if." I suggest that you go ahead and explore them. As Bob said earlier, if you spend a lot of time just going back and forth on it, the opportunity will be gone. Somebody else will have already done it, or somebody else will be way ahead of you. It's very easy to take a negative look at these things, but we're suggesting you give it a try.

MR. GLASSNER: It used to be said that, if you do what you've always done, you'll always get what you've always got. That just isn't true in this business anymore. You're going to have to take a different, and sometimes even radical, approach to how you're going to market your product. I mean the proposal for the 35-year-old male is done; it's over with, at least for the foreseeable future. But we have to change the way we look at things. For example, I think five to eight years ago, there were 1.5 million new family start-ups in our community that we marketed to. Last year, that number fell to 450,000. We have to shift the way we look at the market.

Rodney and I got off on a tangent when we were planning for this meeting regarding this age wave market analysis that is going on in our business. We read that $7 trillion will be passed down from the senior market to the baby boomers in the next five years, and our industry needs to find a way to become a repository of that money. Very few companies in our industry are prepared for this market. Forming a partnership might be the answer. We need to focus on what we can do from an expenses, marketing and profit standpoint. Focus on that. Don't worry about having every product for your distribution. Find out what you do well; do it; and then somebody else can help you do the other part until you are in a stronger position and are able to add more products. The giant companies can do anything they want, I suppose, but most companies can't.

MR. BROWN: I just have some insights. First, make sure the venture fits your corporate strategy. Don't get on something just because you think it's hot. Make sure it's consistent with your objectives, and get some buy-off from the top at least. Then set yourself up with some kind of simple criteria so that you can decide relatively quickly whether a venture is worth pursuing or not. Examples are: Does the venture fit the market that you want? Does it fit a strategy that you want? Is it the right partner? Is the opportunity right? Come up with some kind of check-offs where you can decide relatively quickly whether you want to talk anymore with these folks. You won't believe how many opportunities are going to come up. They will. You go out and start looking for them. They'll start finding you. When we first started, we were making some really bad decisions, and we hope we're making better decisions. Now we're finding that we're going to have to decide relatively quickly whether to get into these things or not. I already mentioned a third-party facilitator as a worthy consideration. Another point is to find a compatible partner. Consider the old 500-pound gorilla story. You don't want that kind of monkey on your back. Companies have totally different philosophies on how to make money. You might have stock/mutual conflict. It may not work. You need to settle on consistent profit objectives. Watch out for the "not-invented-here syndrome." If the group that you're partnering up with isn't thinking the same way, doesn't talk the same language or hold the same philosophy about what works and what doesn't, kill the deal. Get onto something else. Finally, as our friend from Australia pointed out, I say look outside of the industry. Look outside of the domestic market. Look for marketers that are marketing retail products or marketing wholesale products to the markets that you're going to. Look for development companies. Look for consulting companies. Look for somebody else that has a different perspective on the world, and find out if that company can help you. Don't just put those blinders on and say, "They have to look just like me or I won't invite them to the dance."

MR. HARRIS: I have a question. Are there any tax or risk-based-capital (RBC) advantages to farming out some of your business? For example, maybe farm out health insurance if you didn't want the RBC hit from health insurance. Is this something that you run into with your potential partners?

MR. GLASSNER: I think term insurance fits that. If you get the term product down to where it supposedly has to be in order to market it, I think there are some advantages in your RBC management to farm the term portion out the back door, with no questions, particularly with a smaller company. And that market is now being serviced.

MR. BROWN: Well, financial reinsurance is not dead. It's just the bad financial reinsurance that's dead. I mean there's still going to be more and improved financial reinsurance agreements to attack these issues, and they're evolving every day.

MR. GLASSNER: Should we move over to another section? We've jumped around. We may be coming to a close here real quickly.

I have one other concept that fits the joint venture called cut through. I'll mention it briefly, because I believe it has no growth potential. Cut through is a casualty term, and one of the initial reasons for getting a partner was this credit enhancement, or the fact that your ratings are at a level that does not suit the market. There are agreements available. For example, if you're an A-company, and it's restricting your participation in a market, such as the COLI marketplace, find a partner with an appropriate rating, and enter into a cut-through agreement, which entails a contract and a trust agreement. This is a promise of the stronger company to assume that weaker company's business if triggering mechanisms are hit. Assumption agreements are being frowned upon by many state regulators. I do know that in 23 states cut-through agreements are allowed, and this has happened in the last four years. In the casualty business, it's been around for a long time.

MR. STEPHEN A. HARDACRE: I guess it's a tacit assumption that, if you're dealing with a company, it is always going to be solvent. I would think that as a direct writer you're selling a product on your paper, and you're always liable for it. Has there been any problem so far where the company that you've been passing it through to has actually gone under? Ultimately it's on your paper, and you're at risk.

MR. GLASSNER: To my knowledge, the answer to the question is no.

MR. HARDACRE: I thought that Monarch did that. It had several products, and Monarch is no longer in business.

MR. GLASSNER: But insolvency should be addressed in any of these kinds of agreements. That's part of the comment that Andrew made. There's not a reinsurance agreement that exists to my knowledge that doesn't have insolvency issues.

Now, the interesting thing about reinsurance agreements is that insolvency of the ceding company is discussed, rather than the solvency of the reinsurer. I've never understood that, but that's just the way it has always been. I know the situation about Monarch that you're talking about, but I don't think anybody got hurt in those situations. Likewise has any policyholder ever gotten hurt to date with regard to a company actually becoming insolvent? Of course, it needs to be addressed. And how do you get out of this thing, or how do you recapture the business?

But insolvency should be addressed in all agreements, as Andrew said earlier. To my knowledge, all reinsurance agreements have insolvency clauses.

MR. HARRIS: I ran into one deal where one company had gone to another company on the West Coast that had supposed expertise in junk bonds and sold lots of annuities where this West Coast company handled the investments in a trust fund. To my knowledge that trust fund is still tied up. So, you have to be a little careful sometimes about what you do.

MR. COMM: You've made the comment that these arrangements shouldn't be made forever. In situations where companies have done this for the purpose of bringing a product in, do they typically get into this with the idea that, if they bring it in and it works, they will some day develop their own or build up their own?

MR. GLASSNER: It has been done both ways. I know of one example in the universal life (UL) market. You can almost ask this question: If you test-marketed your UL market ten years ago and looked at the return on that particular product, would you have ultimately gotten into it after five years of experience of seeing the return, the persistency, and all the other elements of that particular policy? I see it both ways. I see companies that are getting into the corporate agency for their distribution with no desire to ever be in the disability marketplace on a full-blown basis. On the other hand, others will use a turnkey approach as a first step into the marketing. So, it can go either way.

MR. STEVE P. COOPERSTEIN: On a simple deal where rather than transfering paper, you transfer another company's marketing, let's say in disability, what would the compensation be to the writing company in terms of the type of commission, so to speak, they would be allowed for writing Company A's business?

MR. GLASSNER: Well, I would suggest to you that the product was built with a certain allowable commission scale. That commission scale would be paid to the writing company, and then the writing company has to make the decision whether to keep a portion of that commission for its expenses or pay the full commission to the agent.